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IN THE

Supreme Court of the United States

October Term, 1964

No. 501

HUGHES TOOL COMPANY,

Petitioner,

v.

TRANS WORLD AIRLINES, INC., THE EQUITABLE LIFE ASSURANCE SOCIETY OF THE UNITED STATES, *et al.*,

Respondents.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

JOINT BRIEF FOR ADDITIONAL DEFENDANTS-RESPONDENTS

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February 18, 1965

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ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

JOINT BRIEF FOR ADDITIONAL DEFENDANTS-RESPONDENTS

This brief is submitted on behalf of respondents The Equitable Life Assurance Society of the United States (Equitable), Metropolitan Life Insurance Company (Metropolitan), Irving Trust Company (Irving), Dillon, Read & Co. Inc. (Dillon Read), Ben-Fleming Sessel (Sessel), James F. Oates, Jr. (Oates), Harry C. Hagerty (Hagerty) and Charles C. Tillinghast, Jr. (Tillinghast) (collectively referred to herein as the Additional Defendants). Petitioner Hughes Tool Company (Toolco) named these respondents as Additional Defendants, pursuant to Fed. R. Civ. P. 13(h), to counterclaims filed by it in an action brought against Toolco, Howard R. Hughes (Hughes), Toolco's sole stockholder, and Raymond M. Holliday (Holliday), Toolco's Executive Vice President, by respondent Trans World Airlines, Inc. (TWA) in the United States District Court for the Southern District of New York.*

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* A companion case, No. 443, concerns a judgment of the Court of Appeals affirming orders issued by the District Court with respect to TWA's complaint.

Opinions Below

Petitioner here seeks reversal of a judgment of the United States Court of Appeals for the Second Circuit which modified and, as modified, unanimously affirmed judgments of the United States District Court for the Southern District of New York (Metzner, J.), dismissing with prejudice five counterclaims asserted by Toolco against TWA and the Additional Defendants.

The judgments of the District Court were entered upon companion motions made by TWA and the Additional Defendants to dismiss Toolco's counterclaims for its "wilful and deliberate disobedience" (AA-212)* of orders of that Court directing Toolco to produce two categories of specified documents for inspection and copying and to produce its managing agent, Hughes, for oral examination.

The companion motions, and a motion by TWA for a default judgment, were each based upon the same acts of disobedience and violation of the same orders of the Court. The District Court, therefore, did not write a separate opinion with respect to each motion but merely filed a memorandum decision granting the motion of the Additional Defendants "for all of the reasons stated in

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* The record references used herein are similar to those used by Toolco. References to "AA" are to Toolco's printed appendix in the Court of Appeals in this case, now vol. I of the printed record in this Court as to this case. References to "T" are to TWA's printed appendix in the Court of Appeals in this case, now vol. II of the printed record in this Court as to this case. References to "B" are to the printed appendix of these respondents as Additional Defendants in the Court of Appeals in this case, now vol. III of the printed record in this Court as to this case. References to "A" are to Toolco's printed appendix in the Court of Appeals in No. 443, now vols. I & II of the printed record in this Court as to No. 443. References to "R" are to the additional material in this case and in No. 443 printed in this Court (vols. IV, V & VI). References to "f" are to unprinted portions of the original record.

All emphasis is supplied unless otherwise indicated.

the opinion and order entered on the companion motion by Trans World Airlines, Inc., for a default judgment and dismissal of the counterclaims with prejudice" (AA-206).

Among the findings of the District Court were the following:

1. "At the hearing counsel for Toolco stated that he had advised his client of the sanctions available to TWA under Rule 37, and that by insisting upon a right to obtain a review of the legal questions involved in the proceedings to date Toolco understood that it might be deprived of further defending on the merits. Counsel referred to this as a 'business decision.'"

2. "Counsel also stated that he did not intend to further litigate the counterclaims until after a determination of a complaint filed by Toolco with the Civil Aeronautics Board on February 6th which includes some of the allegations of the counterclaims."

3. "Embraced within the refusal to proceed with the deposition of Hughes is the refusal to obey the orders of the court directing Toolco to produce * * * documents * * *."

4. "* * * It is clear that the deposition of Hughes is essential for the proper presentation of TWA's case. It is also clear that the failure of Hughes to appear on February 11th for his deposition was the result of a clear and studied determination by Toolco after all efforts to postpone the appearance of Hughes had failed. The default was deliberate and willful and justifies the court in entering a default judgment as provided in Rule 37(b)(2)(iii) and 37(d)" (AA-203-204; 32 F. R. D. 604).

Based upon the opinions and orders of May 3, 1963, the District Court entered final judgments on May 28, 1963, dismissing with prejudice the counterclaims against TWA and the Additional Defendants (AA-211, AA-212-213).

In a unanimous opinion (R. 1413; 332 F. 2d 602) the Court of Appeals for the Second Circuit held that four of the five counterclaims could be adjudicated by the District Court, which had properly denied Toolco's request for a stay pending action by the Civil Aeronautics Board (CAB). It further held that the discovery orders of the District Court were proper, that the deposition of Hughes was "necessary to all aspects of this litigation" and that "both TWA and the additional defendants had the right to depose Hughes." The Court of Appeals noted that "Hughes and Toolco seemed to look upon the entire discovery proceedings as some sort of a game". Accordingly, it found that dismissal of the counterclaims with prejudice was "appropriate, in view of Hughes' intransigence". As to the second counterclaim, based on Section 408 of the Federal Aviation Act of 1958 (49 U. S. C. § 1378), the Court of Appeals held that the CAB had exclusive jurisdiction and that this counterclaim should be dismissed for lack of jurisdiction.

Counterstatement of Questions Presented

1. Is it a violation of due process or an abuse of discretion to dismiss a party's counterclaims with prejudice

(a) when that party has repeatedly and deliberately refused to make discovery on crucial matters and ultimately has refused to prosecute, electing to "rest on the merits of its position";

(b) when its "position" was a transparent maneuver to avoid discovery by an absurd extension to the counterclaims of the erroneous *Panagra* argument made with respect to the complaint in No. 443;

(c) when the factual basis for that argument is not even remotely presented by the counterclaims; and

(d) when—even if that argument had been made in good faith—it would furnish no excuse for the defaults?

2. Is a District Court ousted of jurisdiction over four claims alleging breach of contract, antitrust violations and a prima facie tort merely because an independent fifth claim is joined alleging a violation of the Federal Aviation Act and the claimant has filed a complaint with the CAB seeking determination of that fifth claim?

3. Is the District Court, in a stockholder's derivative action, compelled to give notice to other stockholders of an involuntary dismissal for refusal to make discovery and refusal to prosecute?

Constitutional Provisions, Statutes and Rules Involved

In addition to the statutes and rules mentioned by Petitioner, the Additional Defendants believe that the case involves the following statute, which is Section 1106 of the Federal Aviation Act of 1958:

> "Nothing contained in this chapter shall in any way abridge or alter the remedies now existing at common law or by statute, but the provisions of this chapter are in addition to such remedies." 72 Stat. 798, 49 U. S. C. § 1506 (1958).

Counterstatement of the Case

A. Introduction.

Petitioner's statement of the case deliberately ignores the facts and circumstances which led the District Court to enter the judgments affirmed by the Court of Appeals. The

Additional Defendants recognize the necessity of meeting Toolco's jurisdictional argument and will demonstrate that it is without merit. However, to enable this Court adequately to review the decisions of the District Court and the Court of Appeals, and to determine whether the District Court was justified in dismissing the counterclaims with prejudice, it is necessary to set forth a full and complete statement of the record on which the District Court relied.

B. Factual Background of the Litigation.

There has been no determination of the factual issues raised by the counterclaims. Toolco's assertion that it had "meritorious" claims against the Additional Defendants is based primarily on its own pleadings (Toolco Br., p. 56). In viewing the alleged merit of the counterclaims the Court should consider that the Additional Defendants have denied the allegations thereof. Moreover, if Toolco had made the discovery ordered by the District Court, the Additional Defendants believe they would have been able to demolish Toolco's charges.

Hughes since prior to 1939 has been the sole stockholder of Toolco and was its president until late in 1960 (AA-31). Toolco, in turn, owned a controlling interest in TWA from 1944 to December, 1960* and until 1961 nominated a majority of TWA's directors (AA-147).

Although TWA's competitors began to purchase large numbers of jet aircraft in 1955, Toolco did not permit TWA to make any arrangements for the acquisition or financing of such aircraft (AA-12). In 1956 Toolco itself contracted to purchase jet aircraft in an amount ultimately to exceed $300,000,000, but it lacked sufficient funds to complete those purchases (AA-56). During this period TWA's creditors repeatedly expressed to Hughes their concern

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* Since December, 1960, Toolco has been the beneficial owner of 78.2% of the outstanding TWA stock which has been held in a voting trust.

over the absence of a financing program to pay for the needed equipment. Hughes ignored them (T-92).

During the same period TWA suffered from serious management problems, which, the Additional Defendants contend, were caused by Hughes. TWA had a "parade of presidents" over the years who, with the exception of one who died in office, had resigned or been discharged from TWA because of disagreements with Hughes (R. 861-875).

In 1959, faced with imminent delivery of the first jets, Hughes retained Dillon Read and two other investment banking firms to act as financial consultants in the preparation and negotiation of a financing plan (AA-58, B-168). At the request of Hughes, Dillon Read developed a leasing proposal, pursuant to which Toolco would retain title to the planes ordered by it and lease them to TWA (AA-58). Toolco did not consummate this plan (AA-58, B-168).

When Toolco first began taking delivery of jet aircraft in 1959, it leased such equipment to TWA on a day-to-day basis pending consummation of a financing plan * (AA-13, AA-58, B-168), except that Toolco was allegedly unable to finance certain planes, six of which were sold to Pan American, TWA's principal trans-Atlantic competitor (AA-13, AA-34).

By early 1960, TWA was in a financial crisis because it did not have enough jet aircraft and because of the impending delivery of additional jet aircraft for which it could not pay (T-85-103). A. V. Leslie, then TWA's Vice President of Finance and a former Toolco employee, wrote at that time that this situation was caused by "Hughes' unwillingness to face the problem" coupled with the fact that "TWA's current Board of Directors are straw men—and thus will take no action unless forced to by Counsel" (T-96-97). Leslie also stated, in a lengthy memorandum

* As more fully set forth at pp. 18-21, *infra*, this arrangement resulted in enormous tax and other profits to Toolco.

reviewing the financial crisis, that "no insurance or banking group would finance TWA unless TWA were defended against *Hughes* in the future—that the current situations might not again occur" (T-96) (Emphasis in original).

As a result of the delays in obtaining financing, TWA's jet equipment program was disrupted and the delivery to TWA of essential jet aircraft delayed, thereby causing loss of revenue and other damages alleged by both TWA and Toolco to be in excess of $35,000,000 (AA-23, AA-25, AA-76, AA-77).

Finally, Hughes, at the insistence of Charles Thomas, TWA's president since 1958, begrudgingly approved the general terms of a financing plan for TWA (B-320-321, T-82-83). That plan contemplated a combination of senior debt in the amount of $165,000,000 (to be placed with banks and insurance companies) and subordinated debentures to be offered to Toolco and the other stockholders of TWA (AA-43, AA-60, B-168). By May, 1960, the investment bankers had obtained commitments from Equitable, Metropolitan and a bank group headed by Irving to furnish the funds required by TWA on terms accepted by it and by Toolco (AA-62, B-169).

Because of the history of TWA's management problems, these huge commitments were conditioned upon continuation of satisfactory TWA management. The creation of a voting trust for Toolco's stock in TWA was not a condition precedent. The lenders, however, did reserve the right to require a voting trust during the term of the loan in the event there was a change in TWA's management which they considered adverse to TWA's credit position (B-167, B-169).

In July, 1960, just before the scheduled closing, Hughes forced Thomas to resign as TWA's president (B-169-170). Thomas's abrupt resignation was a material adverse change of management and the prospective lenders therefore exercised their right not to complete the financing (B-170, AA-

64). However, the lenders did offer to lend TWA the funds if Toolco simultaneously placed its TWA stock in a voting trust and agreed to hold that offer open for 30 days, while TWA and Toolco tried to arrange alternative financing (AA-65, B-170). Toolco and its representatives then attempted unsuccessfully to procure financing for Toolco or TWA from other lenders (AA-66, AA-71, B-171).

In November, 1960, Toolco again requested Equitable, Metropolitan and the banks to proceed with the financing (AA-71, B-171). In December, 1960, Toolco executed a voting trust agreement and agreed to place its TWA stock in the voting trust as an inducement to the lenders to make the contemplated loans to TWA (AA-71, B-171).

TWA (then still controlled by Toolco) filed a petition with the CAB requesting that it grant such approvals under Sections 408 and 409 of the Federal Aviation Act as the Board might deem necessary to permit consummation of the proposed financing of TWA (B-470). In considering the motion, the CAB had before it the proposed voting trust agreement and the other pertinent documents pursuant to which the transaction was to be effected (B-474).

By its Order E-16195, dated December 29, 1960, the CAB, noting "TWA's problems" under Toolco's control, approved the transaction in so far as approval was required and, pursuant to Section 416, exempted the transaction from the requirements of Section 408 to the extent necessary to enable consummation thereof (B-470; 32 C. A. B. 1363). Moreover, the CAB expressly found that the basic terms of the financing, including the voting trust, were in the public interest (B-478-479).

In reliance upon Toolco's transfer of all of its shares of TWA stock to the voting trust, and the CAB's approval thereof, Metropolitan and Equitable loaned to TWA $92,800,000, and a group of banks, including Irving and for which Irving acted as agent, loaned $72,200,000 (AA-43, B-116, B-171).

Acting under the voting trust agreement,* the noteholders selected Ernest R. Breech, former chairman of the board of Ford Motor Company, and Irving S. Olds, former chairman of the board of United States Steel Corporation, to be two of the three voting trustees (B-471, B-479). Holliday, Vice President of Toolco, was selected by Toolco to act as the third voting trustee (B-471). The stockholders of TWA, including Messrs. Breech and Olds representing Hughes' trusteed stock, elected an independent board of directors (AA-72, B-79). The TWA Board of Directors in turn selected Tillinghast to be TWA's president (AA-45, B-64-65).

In 1961 it was necessary for TWA to obtain further funds to finance the acquisition of additional jet aircraft (AA-75-76, B-81). A substantial dispute arose between TWA and Toolco, primarily because Toolco wished TWA to buy Convair aircraft which Toolco was committed to purchase, and TWA's management had concluded that TWA's needs would be better served by the purchase of additional Boeing aircraft (AA-17-21). Although both TWA and Dillon Read sought the aid of others in financing this additional acquisition of aircraft, Toolco was successful in intimidating other potential lenders with the threat of litigation should they loan money to TWA (B-172-173). Accordingly, Metropolitan, Equitable and Irving and other banks loaned an additional $147,000,000 to TWA (AA-17, AA-75-76, B-81).

TWA's new Board of Directors retained independent counsel, Messrs. Cahill, Gordon, Reindel & Ohl, to advise it

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* The voting trust agreement provided that a majority of the outstanding noteholders could select two out of three voting trustees. Toolco was given the right to select the third voting trustee. The original trustees were designated in and were parties to the voting trust agreement (B-471). As the CAB observed in its order, "the Voting Trustees, acting by majority vote, are empowered to exercise their sole and absolute discretion in respect of the TWA stock deposited with them and will accordingly be in control over TWA management and policies" (B-474).

as to whether TWA had any claims against any person as a result of the delay to TWA in obtaining its jet aircraft. On June 30, 1961, TWA filed the complaint which is the subject of the companion appeal in No. 443.

TWA's complaint (AA-1) alleges violations by Toolco, Hughes and Holliday of Sections 1 and 2 of the Sherman Act and Sections 3 and 7 of the Clayton Act, and further alleges tortious interference by Toolco with the business relations of TWA. Through the violations of law alleged in the complaint, TWA claims that Toolco injured TWA by delaying the acquisition and financing of TWA's jet aircraft.

C. The Counterclaims.

In February 1962, Toolco filed its answer to TWA's complaint and in addition filed five counterclaims which are directed primarily against these Additional Defendants, rather than against TWA (AA-40). Toolco now claims that in their entirety, or in "dominant part", the counterclaims fall within that "fraction of the totality of the antitrust laws which this Court held in *Pan American World Airways, Inc.* v. *United States*, 371 U. S. 296 (1963) (*Panagra*) should be relegated to the jurisdiction of the CAB.

Although the counterclaims are extremely prolix, their basic thrust is clear enough. It is alleged that the Additional Defendants through an unlawful antitrust conspiracy beginning prior to 1956 (fourth counterclaim) and the commission of a *prima facie* tort (fifth counterclaim) greatly damaged Toolco, by withholding until December 1960 the needed financing for the aircraft ordered by Toolco. The Additional Defendants have allegedly breached the contracts entered into in 1960 in a variety of ways in an effort to prevent termination of the voting trust in accordance with its terms (first counterclaim). An alleged by-product of all those wrongful acts was that TWA suffered

at the hands of the Additional Defendants the injuries which the complaint asserts were caused by Toolco (third counterclaim). The creation of the voting trust is also alleged to have violated the Federal Aviation Act for lack of CAB approval (second counterclaim). The principal relief sought by the counterclaims is damages to Toolco and TWA and termination of the voting trust.

The first counterclaim (AA-40) is against all of the Additional Defendants, except Oates, Hagerty and Sessel, and is concerned exclusively with acts allegedly committed subsequent to the creation of the voting trust in December 1960. It is grounded upon alleged breach of contract coupled with breaches of fiduciary duty and alleged waste of TWA's assets. The principal relief sought is to enjoin the named Additional Defendants from preventing termination of the voting trust in accordance with the terms of the agreements, plus an accounting for damages to Toolco.

The second counterclaim (AA-49) is against only three of the eight Additional Defendants, Metropolitan, Equitable and Irving, and is the only counterclaim which alleges violation of the Federal Aviation Act. The predicate of that counterclaim, alleged upon information and belief, is the assertion that, in addition to allegedly being in control of TWA through the voting trust, Metropolitan and Equitable are "persons engaged in a phase of aeronautics within the meaning of * * * Section 408" of the Federal Aviation Act (AA-50). The whole fabric of Toolco's jurisdictional argument springs from this single allegation against Metropolitan and Equitable. The principal relief sought under the second counterclaim is a declaration that Metropolitan and Equitable have violated Section 408 and an injunction requiring termination of the voting trust.

The third, fourth and fifth counterclaims are the only ones asserted against all the Additional Defendants. Those three counterclaims contain the great bulk of the charges made against them (compare AA-40 52 with AA-52-80).

The third counterclaim (AA-52) is a derivative stockholder's action brought on behalf of TWA seeking recovery of $135,000,000 in treble damages and termination of the voting trust. It alleges violations of Sections 1 and 2 of the Sherman Act and Section 7 of the Clayton Act. The gist of the multitudinous charges is that the Additional Defendants have conspired to restrain trade in and to monopolize the business of lending money to air carriers and have used the power thus acquired to fix interest rates, to capture the TWA market for financing and to lend money to TWA at excessive rates. As a result of those wrongful acts TWA's acquisition of jets is said to have been substantially delayed. The fourth counterclaim (AA-77) repeats the charges of the third, seeks the same sort of injunctive relief terminating the voting trust and also treble damages, this time to Toolco, in the amount of $231,000,000.

The fifth counterclaim (AA-78) realleges the same overt acts contained in the third counterclaim. However, it proceeds upon a common law theory of *prima facie* tort alleging that what was done by the Additional Defendants was done for the purpose of wilfully and maliciously injuring Toolco and Hughes personally. Toolco again seeks damages, this time in the amount of $77,000,000, and also termination of the voting trust.

Replies to the counterclaims by the Additional Defendants, in effect, deny all of the substantive allegations of the counterclaims (B-61, B-87, B-112, B-149, B-196). As a defense to the second counterclaim *only*, Metropolitan and Equitable pleaded approval of the voting trust by the CAB and lack of jurisdiction by the District Court (B-84-85, B-109-110).

D. Discovery Proceedings.

Upon service of the counterclaims, the Additional Defendants immediately were forced to become active participants in what can properly be described as massive litiga-

tion. Discovery proceedings were in full swing under the supervision of Judge Charles M. Metzner, assigned to the case for all purposes, and a Special Master, Hon. J. Lee Rankin, appointed by the Court. Discovery included both the production of enormous files of documents and a daily deposition program (B-209).

As soon as the counterclaims were filed, Toolco served the Additional Defendants with a deposition notice with respect to twenty-four witnesses, including all of the Additional Defendants (B-27). Prior to commencement of the counterclaims, Judge Metzner, on February 7, 1962, had granted priority of discovery to Toolco and had set up a schedule for the taking of those depositions by Toolco which provided for their completion by the end of April 1962 (A-142-143). Within days after the filing of the counterclaims, the Special Master granted motions by Toolco under Fed. R. Civ. P. 34 compelling the Additional Defendants to produce tens of thousands of documents immediately (B-209).

The stakes in the litigation were extremely high. Toolco's money claims against the Additional Defendants amounted to $366,000,000. In addition, Toolco also sought to terminate the voting trust and thereby return TWA to Hughes' control—taking with him the more than $300,000,000 which the lending institutions had invested in TWA in reliance upon the insulation from Hughes' control which the voting trust provided. Obviously, the defense of litigation of this magnitude would, and did in fact, prove most expensive and time consuming.

The Additional Defendants believed and assert here, as they did below (*e.g.*, R. 8, B-214-215, R. 1238), that the charges made by Toolco were false. It was Hughes himself who had deliberately and for his own tax and other purposes delayed and prevented the acquisition of TWA's jet fleet and the financing thereof. Examination of Hughes would, the Additional Defendants believed, have enabled

them to forge an early determination of the litigation through an appropriate motion (R. 4-5).

It thus seemed imperative to the Additional Defendants that they obtain at the earliest possible date an opportunity to develop from their principal accuser, Hughes, the facts which would demonstrate that the charges made by his creature, Toolco, were untrue.

(1) *Initial Attempts to Examine Hughes.*

Believing they were entitled to the normal priority of discovery accorded to defendants, the Additional Defendants immediately served notices to examine Toolco by Hughes, as managing agent (B-255, B-257, B-278, B-282), and motions for the production of documents by Toolco under Fed. R. Civ. P. 34 (*e.g.*, B-259).* The Special Master granted the Rule 34 motions on February 16, 1962, and ordered Toolco to produce the documents to the Additional Defendants on March 15, 1962, in conjunction with the production to TWA previously ordered (f. 6946, 6951). As to the oral depositions, however, the Special Master denied the motion for priority over those then scheduled under Judge Metzner's order of February 7, 1962 (f. 6955). The Additional Defendants appealed that ruling to Judge Metzner.

By order of March 5, 1962, the District Court partially granted the application of the Additional Defendants by modifying the deposition schedule contained in the order of February 7, 1962, to the following extent:

> "Defendant Hughes Tool Company may continue the depositions scheduled, limited, however, to evidence which bears on plaintiff's claims against Hughes Tool Company. Since a Special Master is presiding over the depositions on a day-to-day basis, he will see to the application of this limitation. Upon

* Neither at the time of the notice nor at any subsequent time did Toolco ever assert that Hughes was not its managing agent or that the Additional Defendants were not entitled to examine him at some time.

completion of this phase of defendant's depositions, the plaintiff shall proceed with its depositions in the order provided in the pretrial order of February 7, 1962. *The additional defendants may participate in such depositions conducted by plaintiff, in furtherance of their own deposition proceedings, or may separately schedule such depositions to follow upon the completion of plaintiff's depositions.* At the conclusion of the deposition proceedings by the additional defendants, the defendant Hughes Tool Company may then resume and complete its deposition proceedings." (AA-87)

The effect of that order was to leave intact the deposition notices served by the Additional Defendants, but to postpone the date for taking such depositions. Thereafter, under the above order Toolco enjoyed the exclusive right to conduct depositions for almost a year until discovery proceedings in the District Court were terminated.*

The only discovery of any kind made by Toolco to the Additional Defendants was the production to them commencing March 15, 1962, of a substantial quantity of documents in New York City, Houston, Texas, and Los Angeles, California (B-211). Since production of these documents for TWA had previously been ordered, the Special Master directed that they be produced to the Additional Defendants as well. Toolco, however, repeatedly resisted production of other documents which were crucial to the defense of the counterclaims.

(2) *Toolco's Repeated Refusals to Produce the Allegedly Privileged Documents.*

Thus, a number of documents admittedly covered by the Additional Defendants' Rule 34 motion and the Special

* During that time Toolco conducted depositions for a total of 80 days consuming 13,000 pages of the record, but nevertheless examined just four witnesses, only one of whom was completed (AA-117, f. 5428-18168).

Master's order were withheld from production by Toolco under a claim that they were protected by the attorney-client privilege (B-212). These documents were potentially of the greatest significance for the Additional Defendants because Toolco had for many years used its counsel as business agents in the negotiations which are the subject matter of the counterclaims (B-212, B-332).

The Additional Defendants, joined by TWA, challenged Toolco's claim of privilege, asserting that any attorney-client privilege relating to the subject matter of the complaint and the counterclaims had been repeatedly and deliberately waived in pleadings and in affidavits (B-326-333). The Additional Defendants submitted affidavits and briefs and Toolco's claim of privilege was argued at great length before the Special Master (B-212). On April 17, 1962, the Special Master ruled that the privilege had been waived by Toolco through disclosure in the affidavits and in its pleadings and ordered the documents in question to be produced for the Additional Defendants (AA-95).

The order of the Special Master was affirmed by the District Court on July 25, 1962 (AA-116). Thereafter, Toolco requested permission to reargue the question of waiver before the Special Master. On September 15, 1962, after hearing reargument and after inspecting the documents, the Special Master again ordered the documents to be produced (AA-92-93, B-458).

The Special Master's order was again affirmed by the District Court on January 10, 1963 (AA-92). In that order, the Court directed that such documents be produced by 12 noon on January 14, 1963 (AA-93). At that time, demand was made on Toolco to produce those documents, but counsel for Toolco refused to make production although he exhibited a package containing them (B-221-222).

By the District Court's order of January 19, 1963, Toolco was retroactively given a second chance until 12 noon on

January 22, 1963, to produce the documents (AA-121). By stipulation of counsel, a stay of production was granted until 5 p. m. on January 23, 1963, to enable Toolco to attempt to obtain review by the Court of Appeals (B-213). An appeal to that Court was dismissed on motion and a writ of mandamus and stay were also denied on January 23, 1963 (B-213).

At a hearing before the Special Master at 5 p. m. on January 23, the Additional Defendants and TWA once again demanded production of the documents. At that hearing counsel for Toolco refused to comply with the orders of the District Court and the Special Master and again refused to produce the documents (B-224, B-232). This was Toolco's first deliberate default.

(3) *Toolco's Refusal to Produce Documents Relating to Hughes' Use of TWA for Tax Advantages for Himself and Toolco.*

TWA's financial misfortunes, including the delay in the acquisition and financing of its jet fleet, were not attributable simply to economic forces and ineffective management, but were due also to a secret and deliberate scheme on the part of Hughes to alleviate his tax burden at TWA's expense (B-277). Tax benefits to Hughes through control of TWA arose in two ways: through avoidance of penalty taxes under Sections 531, *et seq.* of the Internal Revenue Code on earnings accumulated by Toolco and through various manipulations with respect to aircraft leased and eventually sold to TWA.

Toolco's principal business—the manufacture and sale of oil well drilling equipment—has been highly profitable. As a result, Toolco has accumulated vast earnings (B-167) and, also, a problem under Section 531. In order to avoid the unpalatable choice of either paying high penalty taxes on retained income under Section 531 or declaring substantial dividends to Hughes—taxable as ordinary income—Hughes caused Toolco to invest in a variety of unre-

lated enterprises, including TWA (B-167). Because Hughes needed to justify Toolco's accumulation of earnings in terms of the "reasonable needs of the business", it appeared that he deliberately prevented TWA from raising needed equity capital so that it would be dependent upon Toolco as a source of funds (B-167, R. 1239-1243, R. 1245).

One area in which Toolco solved its accumulated earnings problem at the expense of TWA was in the purchase of flight equipment. For example, Rummel, a TWA vice president, testified that Hughes insisted that a contract for certain Lockheed aircraft, to be purchased by Toolco for resale to TWA, be consummated before December 31, 1954, against Rummel's protests that specifications for such aircraft had not been sufficiently developed to make a contract advisable from TWA's standpoint (R. 1078-1082). This contract enabled Toolco to make a $17,000,000 down payment in 1954—when Toolco's net income after taxes was over $20,000,000. Without such expenditure, penalty taxes under Section 531 might well have been incurred (B-243, R. 1245).

The second major area in which Hughes and Toolco appeared to have profited from control of TWA was in the leasing and subsequent sale of jet aircraft by Toolco to TWA. Although these leases were alleged by Toolco to have been made for the accommodation of TWA (AA-58), Toolco in fact made a profit of over $11,000,000 when the leased aircraft were eventually sold to TWA (B-242). Moreover, in connection with the sale of the aircraft to TWA, the evidence available indicated that Toolco was able to convert substantial amounts of ordinary income into capital gain. This was done in part by offsetting accelerated depreciation charges against Toolco's ordinary income (thereby saving it 52¢ on the dollar) while Toolco owned the planes and leased them to TWA. After reducing its cost basis by the amount of such depreciation, Toolco paid only a long-term capital gains tax of 25% when the planes were sold to TWA for cost less normal straight-line

depreciation. It appeared that Toolco was similarly able to profit by converting other sums from ordinary income into capital gains through manipulation of amounts charged to TWA in the form of interest. (B-242-243, R. 1245-1248)

It also appeared that the amount of Toolco's profits and tax savings resulting from the foregoing schemes increased with every day's delay during 1960 in consummating the ultimate financing plan and consequent sale of the leased planes to TWA. Moreover, such tax benefits, which would flow only from a leasing plan, would explain Hughes' insistence upon such a plan, and his consistent refusal to support any orthodox financing proposal for TWA. (R. 1243-1248)

Proof of such facts would confirm the justification for the lenders' insistence on a voting trust and thus independent management before lending money to TWA (B-241). Moreover, proof of these facts would conclusively establish that the delays in obtaining financing and aircraft for TWA were caused by Hughes and Toolco in their pursuit of tax advantages, and not, as the counterclaims charge, by the Additional Defendants (B-173, B-277).

Thus, after a study of the documents originally produced by Toolco, the Additional Defendants, on January 9, 1963, moved for the production of 23 additional categories of documents relating to the foregoing matters (f. 2735f).

In support of that motion, the Additional Defendants submitted an affidavit which set forth at length the substance of the matters referred to above (B-237). That affidavit was uncontradicted by Toolco. The Special Master ordered Toolco to produce the requested documents, stating:

> "It is quite apparent that the documentary evidence requested is relevant to the inquiries in this case. The claim that Toolco's 102 [Section 531 of the 1954 Internal Revenue Code] problems and the profits that Toolco obtained by reason of its rela-

tions with TWA in the procurement and financing of equipment is not a novel contention in this case. It was asserted a number of months ago by the plaintiff in these proceedings.

"It is also obvious that the materials now requested might be important and quite necessary in illuminating, explaining and supporting information either partially or fully set forth in the financial statements and the income tax returns of Toolco that Judge Metzner ordered Toolco to produce in his order of December 18, 1961, calling for their production for March 15, 1962. * * * The importance of having the requested documentary material prior to the taking of the deposition of Mr. Hughes is obvious." B-245-246)

By order of February 1, 1963, the District Court ordered Toolco to produce those documents on a daily basis (AA-144). Production of those documents in accordance with the Court's order was repeatedly demanded by letter and in person (B-177, B-248). Finally, on February 8, 1963, counsel for Toolco categorically refused to produce any of those documents (AA-196). This was Toolco's second deliberate default.

The significance of Toolco's refusal to produce those two categories of documents cannot be overestimated. The Additional Defendants believe that with the aid of these documents and through the examination of Hughes they would have been able to expose the allegations of the counterclaims as sham.

(4) *Toolco's Prolonged and Burdensome Depositions.*

By early spring 1962, it became apparent that the deposition schedule set by the District Court on February 7, 1962, which contemplated the conclusion of Toolco's examination of 23 witnesses by the end of April, no longer had any significance. The first deposition, that of TWA's president Tillinghast, continued from January until the end of July. Tillinghast, one of the named Additional Defend-

ants, had been associated with TWA for only about three months prior to the filing of the complaint (B-90-91). Since he knew less than any of the other scheduled witnesses about Hughes' relations with TWA—indeed he knew nothing except by hearsay about the activities prior to April 1961 which made up the bulk of the complaint and the counterclaims—a realistic appraisal of the length of Toolco's depositions ran into a number of years. To the Additional Defendants it seemed that Toolco was attempting to prolong its own discovery indefinitely, thereby preventing the Additional Defendants from examining Hughes and other Toolco officials.

The depositions were most burdensome to the Additional Defendants. Toolco takes the position that such burden was "gratuitously assumed" (Toolco Br., p. 61, n. 8). That, of course, was not the fact at all.

Two days after the counterclaims were served, Toolco served the Additional Defendants with deposition notices and also notified them that depositions were already in progress (B-27). Shortly thereafter, the Special Master, in response to a plea of counsel for the Additional Defendants that they needed adequate time to prepare, stated that they were required to attend the depositions, and that

> "* * * if you absent yourself, any of you, as far as your clients are concerned, you do it with due notice that I have given you every opportunity to participate and protect your clients' interests." (R. 984)

Similarly, on September 14, 1962, the Special Master reiterated:

> "I have tried to make it clear in these depositions that I expected these additional defendants and parties, whether they attended or not, to be bound by these depositions, and not feel free that they could have evidence adduced here and then come back at some later date and cover the same area at great expense to parties and all of the interested litigants, and therefore I have imposed upon them

> the responsibility of watching out for their clients' interests as to testimony that may be adduced as this case goes along, and also that rules which will be the law of the case during the continuance of the taking of discovery might well be established that would bind them in the future." (R. 1072)

It is true that Judge Metzner's order of March 5, 1962, limited the scope of Toolco's depositions "to evidence which bears on plaintiff's claims * * * " against Toolco (AA-87). However, such limitation did not materially circumscribe Toolco's depositions as to the activities of the Additional Defendants charged in the counterclaims. The dominant strategy of Toolco's defense to the complaint has been the contention that whatever injuries the plaintiff suffered were caused not by Toolco, as charged in the complaint, but by the Additional Defendants, as charged in the counterclaims.

As Toolco itself summarized its position in the Court of Appeals:

> "* * * the counterclaims set up facts which establish that any injury TWA may have suffered in connection with its acquisition and financing of aircraft, particularly jet aircraft, was the result of unlawful conduct on the part of the additional defendants, and not as a result of any conduct by Toolco. In effect, the facts asserted in the counterclaims constitute affirmative defenses to the allegations of the complaint." (R. 1412)

In fact much of the examination conducted by Toolco related almost entirely to the relations between TWA and the Additional Defendants and the relations between Toolco and the Additional Defendants.* As pointed out above,

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* Illustrative of that fact is the number of documents obtained from the files of the Additional Defendants which Toolco had marked as exhibits for identification at the depositions. Those documents included defendant's exhibits Nos. 71A, 88, 89, 90, 104, 105, 106, 148, 149, 206, 209A, 210, 213, 215, 217, 218, 223, 226, 228, 229, 231, 236, 269, 283, 284, 287, 292, 295, 299, 300, 321, 332, 333, 338, 340A, 340, 341A, 342, 342A, 345, 349, 360, 369. Most of these exhibits served as the basis for extensive examination by Toolco.

one of the Additional Defendants, Tillinghast, was examined exhaustively regarding almost everything he had done since—allegedly pursuant to a conspiracy among the Additional Defendants (AA-45-46, AA-72-73)—he became president of TWA in April 1961.*

Moreover, at Toolco's urging (B-32), the Additional Defendants were required by the District Court to pay two-thirds of the Special Master's fee for his services in connection with the discovery proceedings (B-29)—a burden which Toolco now says the Additional Defendants "gratuitously assumed".

(5) *The Additional Defendants' Renewed Attempts To Examine Hughes.*

For many months, TWA had been searching for the elusive Hughes in order to serve him with a subpoena. On May 2, 1962, TWA served interrogatories on Toolco designed to ascertain the whereabouts of Hughes so that a subpoena could be served (f. 1212, f. 1220). The Special Master ordered Toolco to answer the interrogatories unless Hughes authorized some person in writing to accept service of a subpoena on his behalf (f. 9989-9990). The District Court affirmed that order on July 12, 1962 (AA-88). On September 6, 1962, Chester C. Davis, counsel for Toolco, accepted service of a subpoena duces tecum for Hughes as a witness returnable on September 24, 1962, at the United States District Court House in Los Angeles (B-216).

On September 15, 1962, TWA, on the basis of its subpoena, and the Additional Defendants, on the basis of their notices to examine, joined in an application to the Special Master to suspend the examination of TWA then being conducted by Toolco so that the deposition of Hughes could be taken on September 24, 1962 (f. 18265-18266). The Special Master denied that application, but said in part:

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* Despite this fact, Toolco's brief states, "Not one additional defendant was examined on deposition" (Toolco Br., p. 61).

> "I feel that there is such a close connection between Mr. Hughes, as evidenced by some of the documents that I have seen, and the fact that he is the sole owner of the Hughes Tool Company, that the Hughes Tool Company is responsible for Mr. Hughes with regard to this subpoena * * *."
>
> * * *
>
> "* * * I am piercing the corporate veil as to the Hughes Tool Company, and I am bringing what I hope is clear notice of very substantial sanctions, not against Mr. Hughes, but against the Hughes Tool Company, in case there should be at some later date a claim of lack of authorization or failure to respond to the subpoena * * *." (R. 1227-1228)*

On September 21, 1962, the District Court modified the order of the Special Master and set the date for the Hughes deposition for October 29, 1962. The Court went on to say:

> "* * * The Special Master stated for reasons set forth in the record that unless Howard R. Hughes communicated with him by today, Friday, September 21st, 1962 he would consider that Mr. Hughes has acquiesced in this interpretation and that if Mr. Hughes subsequently either attacked the validity of the subpoena or failed to appear pursuant to that subpoena on September 24th, 1962, or at any future time that the court might direct for the taking of the deposition of Mr. Hughes pursuant to that subpoena, he, the Special Master, would consider the imposition of sanctions upon the Tool Company, and that he would entertain a motion to strike the answer of the Tool Company and enter judgment against it.
>
> "Without passing upon the power of the Special Master to grant the entry of such judgment, the court adopts the interpretation and conditions expressed by the Special Master. Any determination

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* On February 8, 1963, counsel for Toolco stated with respect to this decision of the Special Master: "* * * the Tool Company did not seek a review of those rulings of the special master by the Court and accepted in effect the responsibility placed upon it by that ruling." (AA-167).

> by the Special Master on an application for a default judgment would, of course, be reviewable upon appeal to the court." (B-46)

Toolco then began a series of maneuvers calculated to postpone as long as possible the scheduled examination of Hughes. On September 25, 1962, Toolco moved for a pre-trial conference under Fed. R. Civ. P. 16 for a definition and narrowing of issues * (f. 1914). Early in October, Toolco served a series of massive interrogatories on TWA (f. 27491, f. 2214), which the Special Master ordered TWA to answer (AA-93). TWA appealed that order to the District Court (AA-93).

(6) *The Final Setting of the Hughes Deposition for February 11, 1963.*

On October 25, 1962, Toolco again sought to adjourn the date of the examination of Hughes beyond October 29, 1962, for which it was then set. Over objections by TWA and the Additional Defendants (B-498), the Special Master granted Toolco's application for an adjournment (B-455). However, the Special Master ordered "that the deposition of Howard R. Hughes be adjourned to February 11, 1963, and that the return date for the notice to take depositions [served by the Additional Defendants] and the subpoena [served by TWA] be adjourned to that date" (B-460). The Special Master pointed out that Toolco would, on February 11, 1963, have had the exclusive right to conduct discovery for more than a year and that by setting February 11 Toolco would have a "reasonable time to present whatever motions it cared to to the Court with regard to the jurisdiction of the Court over the subject matter and

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* Neither TWA nor the Additional Defendants opposed a definition of the issues. Rather, they took the position that definition of the issues was premature until they, as had Toolco, had some opportunity to discover the facts underlying the claims through examination (R. 175-176).

elements of primary jurisdiction, exclusive jurisdiction, or other legal issues of that character * * *" (B-460).*

(7) *Toolco's Continued Efforts To Prolong Its Discovery.*

In addition to its request for a definition of the issues and the interrogatories served upon TWA prior to October 25, Toolco adopted other measures to postpone discovery of the facts underlying its counterclaims.

On December 4, 1962, Toolco brought on before the Special Master a motion to interpose the deposition of three other Additional Defendants, Dillon Read, Sessel and Irving, before the deposition of Hughes (B-503). The Additional Defendants opposed on the ground that the examination of Hughes by all parties should proceed as scheduled. On December 28, 1962, the Special Master rejected this maneuver by Toolco, stating:

> "I am now denying the application and motion of the Tool Company to depose Mr. Sessel and the Irving Trust Company by Mr. Sessel and Mr. Wadsworth and Dillon, Read at any time prior to taking of the deposition of Howard R. Hughes, which is to begin on February 11, 1963" (B-466).

At the same time, the Special Master reviewed at length his order of October 25, 1962, setting the Hughes deposition for February 11, "to remove any doubts about it, that I set the date with the intention and expectation that the deposition would start at ten o'clock on that morning and proceed until it was concluded according to law" (B-464-465).

Toolco then for the first time appealed the Special Master's decision setting February 11 for the Hughes examination to the District Court.

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* Toolco first made its motion to dismiss the complaint on August 8, 1961. Although Toolco repeatedly stated its intention to bring the motion on for argument, it did not do so until January 1963 (AA-119).

(8) *The District Court's Order of January 10, 1963.*

On January 10, 1963, the District Court, after receiving numerous briefs and reviewing all of the transcripts before the Special Master and hearing the matters reargued (B-287), entered an order disposing of a number of the motions made by Toolco. The order provided, among other things, as follows:

> (i) It denied Toolco's motion to interpose the depositions of Sessel and Wadsworth prior to the deposition of Hughes and stated:
>
> > "* * * The deposition of Howard R. Hughes by the plaintiff and the additional defendants should now go forward. This deposition was originally scheduled for September 24th, 1962, and then adjourned to October 29th, 1962. It has now been adjourned to February 11, 1963 and this date will be adhered to in the absence of extraordinary circumstances."
>
> (ii) It denied Toolco's Rule 16 motion, with leave to renew after the deposition of Hughes.
>
> (iii) It permitted TWA to postpone answer to Toolco's interrogatories until after Hughes' deposition.
>
> (iv) It again affirmed the Special Master's ruling on waiver by Toolco of the attorney-client privilege and ordered the subject documents produced by noon on January 14, 1963 (AA-90).

The fundamental effect of this order was to suspend discovery by Toolco of TWA and the Additional Defendants and to require Toolco at last to divulge to the other parties the facts underlying its claims and defenses.

Thus, the next order of business was the production by Toolco of documents and the deposition of Hughes. To those procedures all parties, except Toolco, turned their attention. In his order of October 25, 1962, the Special

Master had recognized the substantial logistical problem in transferring the massive files and substantial numbers of personnel to Los Angeles where the Hughes deposition was to be conducted (B-459). The Additional Defendants particularly had repeatedly pointed out to Toolco that they were incurring substantial expenses to prepare to take Hughes' deposition in California, and that if any delay was contemplated by Toolco prompt notification should be made so that such expenses could be avoided (B-314).

(9) *Toolco's Final Desperate Stratagems To Delay the Deposition of Hughes.*

On January 14, 1963, Toolco served a motion requesting either that the Hughes deposition by TWA and the Additional Defendants be by written interrogatories, or, *but only in the alternative*, that a schedule be set for hearings on Toolco's motion, pending since August 8, 1961, to dismiss TWA's complaint (AA-117, f. 2496-2497).

Toolco's counsel described the lengthy examination which it expected TWA's counsel to make of Hughes and stated that, "under the Court's order of March 5, 1962, the additional defendants would appear to be entitled to participate in oral deposition of Mr. Hughes and their examination would extend to matters relevant to Tool Company's counterclaims" (f. 2504-2505). Toolco's counsel also pointed out that "counsel for [the Additional Defendants] have stated that they are already incurring large expenditures in preparation for their participation in the deposition, thus indicating that they expect to conduct a protracted examination" (f. 2505).

By order of January 19, 1963, the District Court denied the motion to depose Hughes by written interrogatories and set a briefing schedule for the motion to dismiss the complaint (AA-117). In addition, because counsel for Toolco "was reluctant to indicate whether he desired to hold the deposition at some place other than in the United States

Courthouse in Los Angeles" (AA-121), the Court instructed Toolco to advise the Additional Defendants and TWA by noon on January 22, 1963, if it desired them to conduct the examination of Hughes at some other place (AA-121). No such notice was ever given (B-228-229). The Additional Defendants and TWA then completed their preparations for the examination of Hughes in Los Angeles—even to the extent of setting up a separate office there for that purpose (B-210).

(10) *Toolco's CAB Complaint and Its Motion To Stay.*

On February 6, 1963—three business days before the scheduled examination of Hughes—Toolco suddenly filed a complaint with the CAB naming all of the Additional Defendants and two others as respondents (AA-145). In fact, however, as Toolco admitted in that pleading, only three of the Additional Defendants—Metropolitan, Equitable and Irving—were really charged with any violations of law in the CAB complaint. The other Additional Defendants were added to the CAB complaint by reason of their interest in the litigation pending in the District Court (AA-153). Toolco requested a broad-scale investigation by the CAB as to whether the acts alleged in the complaint violated Sections 408, 409 or 411 of the Federal Aviation Act. On the basis of that complaint, it then immediately moved in the District Court for an order "that all further proceedings * * * be stayed" on the counterclaims which Toolco had itself brought against the Additional Defendants (AA-263). Toolco's motion to stay was denied by the District Court on February 8, 1963 (AA-195, f. 3799). Its motion to dismiss the complaint had been denied the day before (B-180).

(11) *Toolco's Notice of Position.*

On February 8, 1963, the last business day before the scheduled examination of Hughes, Toolco announced to the District Court that it had made a "business decision" not to proceed further with discovery (AA-173). Toolco's

counsel did that on the basis of a "notice of position" which Toolco now claims stated only that it would "proceed no further with discovery on the *complaint*" (Toolco Br., p. 24). In fact, that notice of position stated:

> "• • • the position of Toolco [is] that it may not be properly subjected to further discovery proceedings by plaintiff *or the additional defendants* at this time" (B-178).

The notice then expressed Toolco's election

> "to rest on the merits of its positions as heretofore taken so that it may avoid the burdens and expenses involved in further pre-trial and trial proceedings" (B-178-179).

On that same day, a lengthy hearing was held before the District Court in which Toolco's counsel elaborated upon the "notice of position", stating in part as follows:

> "I have also had occasion to describe to my client, the Hughes Tool Company, the sanctions available under the Rules by reason of a respectful declination or election to stand on the questions of law which have been decided to date and not to proceed any further with respect to discovery proceedings. I have particularly called to their attention the provisions of 37(d)—Rule 37(d)—of the Federal Rules, with respect to the sanctions which could be applied by the Court on the Tool Company." (AA-167)
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> • • •
>
> "The Tool Company does want to rest on the merits of its position, and it does so fully aware of the sanctions which the Court, in its discretion, may impose upon the Tool Company • • • " (AA-168).
>
> • • •
>
> "• • • we do not consent in the sense of requesting the Court to strike our pleadings or take any other action, but we are fully aware—my client is fully aware—that by insisting on a right to obtain

> a review on the legal questions which have been decided to date, and should it develop that they are in error, as indicated by your Honor's decisions and rulings, as a consequence they may be deprived of further defending on the merits, other than on the question of damages." (AA-169)

Referring specifically to the counterclaims, Toolco's counsel then stated that "the position of the Tool Company with respect to these additional defendants is comparable * * *" (AA-174). However, counsel then went on to argue that the Additional Defendants really should not be permitted to examine Hughes on February 11 and that the motion for a stay on the basis of the CAB complaint ought to be granted (AA-174 *et seq.*). After considerable discussion, the Court pointed out:

> "* * * I do not see, Mr. Davis, how you can do anything else but take a dismissal with prejudice on your counterclaims, otherwise the additional defendants are perfectly justified in going out to California and noting the default of Mr. Hughes and coming back and moving for a dismissal with prejudice" (AA-192).

To that, counsel for Toolco replied:

> "I am perfectly prepared to state, if that will facilitate the procedural matters, that the Tool Company, in so far as these counterclaims are concerned, does not intend to pursue litigating those counterclaims in this Court until after there has been a determination by the CAB * * *" (AA-192).
>
> * * *
>
> "* * * if they [the additional defendants] * * * would like to have a notation on the record of the position of the Tool Company and the failure of Mr. Hughes to appear, they can have that also, and then they can make whatever application they want which will produce whatever order the Court will grant them" (AA-193).

Finally, the District Court took the time to recite carefully to Toolco's counsel the state of the record.

> "I want to point out to you, Mr. Davis, that Mr. Hughes' appearance on February 11th was not solely in conjunction with the deposition to be conducted by TWA but was also in conjunction with the counterclaims which you have asserted against TWA and the additional defendants; that notices to take that deposition were properly served; that the Court fixed an order of priority of deposition and indicated when the deposition of Mr. Hughes would go forward in so far as the additional defendants were concerned, and that was reiterated in the pretrial order of this Court on January 10th. So that if Mr. Hughes is not appearing—and even if he does appear, as far as we are concerned in this litigation, he has not appeared, on your concession—then the appearance is in default and in violation of the notices and the prior orders of this Court" (AA-196).

Toolco's counsel nevertheless adamantly refused to produce Hughes for examination and again refused to turn over to the Additional Defendants the documents which the Court had previously ordered it to produce (AA-196-197). This was Toolco's third deliberate default and included a refusal to proceed further in litigating its counterclaims. Toolco's position in its notice and at the February 8 hearing was taken on the basis of a "business decision * * * to stand on the validity or the merits of our positions to date" (AA-173).

E. Dismissal of the Counterclaims.

Thereupon, TWA moved for a default judgment on its complaint and for dismissal of the counterclaims with prejudice (f. 4970). The Additional Defendants filed a companion motion for dismissal of the counterclaims with prejudice. Their motion was made under Rules 37(b)(2) and 37(d) for failure of Toolco to comply with orders of the Court requiring discovery and under Rules 41(b) and

41(e) for failure of Toolco to prosecute its counterclaims (B-205). On May 3, 1963, the District Court filed companion opinions and orders granting the relief requested on each motion (AA-200, AA-206).

On May 28, 1963, final judgments were entered dismissing with prejudice each of the five counterclaims against TWA and the Additional Defendants (AA-211, AA-212-213). The Court of Appeals affirmed after modifying the judgment so as to provide for a dismissal of the second counterclaim for lack of jurisdiction (R. 1413-1437).

Summary of Argument

In this protracted and expensive litigation, Toolco was ordered to produce two vital categories of documents for inspection and copying and to produce its managing agent, Hughes, for examination before trial by the Additional Defendants. Those conventional discovery orders were proper in all respects. If they had been obeyed, the crucial underlying facts in this litigation would have been revealed. Toolco repeatedly refused to comply with any of those orders. Following those refusals to make discovery, Toolco, stating its awareness of the consequences, announced a business decision to refuse further to prosecute these counterclaims. Thereupon, the District Court dismissed the counterclaims with prejudice and the Court of Appeals affirmed. Respondents submit that under the express provisions of Fed. R. Civ. P. 37 and 41, as well as this Court's decisions in *Hammond Packing Co.* v. *Arkansas*, 212 U. S. 322 (1908), and *Link* v. *Wabash R. R. Co.*, 370 U. S. 626 (1962), dismissal of the counterclaims with prejudice was obviously proper and in accordance with due process.

Toolco tries to excuse its conduct below because of its "position that this Court's decision in *Panagra* precluded the present prosecution of its counterclaims" (Toolco Br., p. 27). That excuse is argued on two levels. First, Toolco

contends—on this appeal for the first time—that the District Court was deprived of jurisdiction over the counterclaims by this Court's decision in *Panagra*, and hence dismissal without prejudice was required. Second, Toolco argues that even if that position is wrong, it was nevertheless entitled to refuse to make discovery and to refuse to prosecute its counterclaims because it believed that position was correct.

Dealing with the latter argument first, the record shows that, contrary to its present position, Toolco's counsel three times told the District Court that it did not want and was not seeking a dismissal without prejudice. Moreover, Toolco now concedes that the only relief which it requested in the District Court—a stay—should not have been granted. Thus, Toolco now asserts that because it now believes that the District Court should have granted precisely the relief which it then told the District Court it did not want, Toolco was then justified in refusing to obey the orders of the District Court to make discovery and in refusing to prosecute its counterclaims. We submit that position is absurd.

Toolco's further arguments in support of a dismissal without prejudice are frivolous make-weights. Its self-serving contention that it had meritorious counterclaims is legally irrelevant, as is its plea that it could have taken a voluntary dismissal at some earlier point in the case. Its assertion that the Additional Defendants were not prejudiced by the pendency of the counterclaims is contradicted by the record, which shows that the Additional Defendants made huge expenditures of time and money which were deliberately aggravated by Toolco's own actions.

In any event, Toolco's excuse is chronologically insufficient. Toolco defied discovery orders of the District Court even before its counsel had ever heard of this Court's *Panagra* decision, and thus its reliance on *Panagra* as a justification for its conduct below is merely a smoke-screen.

In support of its present position, Toolco strains to apply to the counterclaims the arguments based on *Panagra*

and the Federal Aviation Act on which it relies in No. 443. In contrast to the situation in the companion appeal, the CAB has not assumed jurisdiction over the relationship between TWA and the Additional Defendants, nor has it issued any orders regulating that relationship. Moreover, no claim is made that the Additional Defendants have been exempted from liability by the CAB. Instead Toolco allegedly fears that the CAB in the future may grant an exemption to the Additional Defendants which they have never sought, and which will then insulate them from Toolco's antitrust and common law claims. In fact, nothing which the CAB might do could ever lead to such an exemption. Toolco's argument to the contrary is contradicted by prior decisions of this Court, including *Panagra*, as well as by the provisions of the Federal Aviation Act. Thus Toolco was not entitled to defy the court below and abandon its counterclaims by filing a complaint with the CAB which might, Toolco says, lead to a defense for its adversaries.

Clearly the District Court had jurisdiction over the private wrongs alleged in Toolco's counterclaims. The subject matter of these claims presented issues which the District Court was fully capable of adjudicating, and in no way fell within the scope of the regulatory authority or expertise of the CAB.

In any event the premise of Toolco's jurisdictional argument—that the Additional Defendants have unlawfully acquired control of TWA—is fallacious for three reasons. First, the voting trust agreement, which allegedly resulted in this acquisition of control, was specifically approved by the CAB as in the public interest. Second, none of the Additional Defendants is engaged in a phase of aeronautics. Third, five of the eight Additional Defendants are not even claimed by Toolco to be engaged in a phase of aeronautics.

Finally, although the Court need not reach the question at this time, notice to stockholders under Rule 23(c) was not a prerequisite to dismissal of the derivative coun-

terclaim with prejudice. Toolco's refusal to reveal material evidence under discovery orders, or to prosecute its claim, gives rise to a factual presumption that the derivative counterclaim is without merit. Thus the dismissal falls within the well-established principle (conceded by Toolco) that Rule 23(c) does not apply to involuntary dismissals on the merits.

ARGUMENT

POINT I

The Court of Appeals correctly concluded that the dismissal of the counterclaims with prejudice was proper.

Toolco wilfully and deliberately refused to comply with three separate discovery orders initially made by the Special Master and affirmed by the District Court—two orders to produce the two categories of documents and the order to produce Hughes for examination. Ultimately, Toolco bluntly refused to prosecute the counterclaims.

The three discovery orders were clearly correct and Toolco does not now seriously contend otherwise. Both Judge Metzner and the Special Master actively participated in the supervision of discovery. The decisions of the District Court and the Special Master that Hughes should be examined by the Additional Defendants on February 11, 1963, were proper exercises of their undoubted discretion to control the priority of discovery. The decisions that Toolco had repeatedly waived the attorney-client privilege, in its pleadings and in several affidavits, were based upon thorough familiarity with the subject matter of the action and careful consideration of the precedents.*

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* Petitioner's statement of this phase of the discovery proceedings (Toolco Br., pp. 66-67) is completely inaccurate and misleading. Compare Petitioner's recitation with pp. 16-18, *supra*.

The decisions that good cause had been shown for production of the tax documents and the orders to produce such documents are beyond question. To Toolco's three specific refusals to make discovery must be added Toolco's final refusal "to pursue litigating those counterclaims in this Court until after there has been a determination by the CAB" (AA-192; see AA-203).

Faced with this situation, what action should the District Court have taken? Respondents submit that under prior decisions of this Court the only proper course for the District Court to follow was to dismiss the counterclaims with prejudice for two separate reasons:

First, the District Court was required to dismiss the counterclaims with prejudice under Fed. R. Civ. P. 37(b) and 37(d) for Toolco's refusal to comply with the discovery orders;

Second, the District Court was required to dismiss with prejudice under Fed. R. Civ. P. 41(b) and 41(c) for Toolco's refusal to prosecute its counterclaims.

A. The District Court was required to dismiss the counterclaims for Toolco's wilful and deliberate refusal to comply with discovery orders.

Since the Judiciary Act of 1789, federal courts have had the power to dismiss an action for failure of a party to comply with discovery orders. *Hammond Packing Co.* v. *Arkansas*, 212 U. S. 322, 351 (1908). That case is precisely in point. There the defendant refused to produce witnesses and documents on the ground that the order of the Arkansas court requiring production was violative of due process and constituted an unreasonable search and seizure. This Court affirmed the entry of a default judgment in favor of the plaintiff, stating:

> "This case presents a failure by the defendant to produce what we must assume was material evidence in its possession and a resulting striking out

> of an answer and a default. The proceeding here taken may therefore find its sanction in the undoubted right of the lawmaking power to create a presumption of fact as to the bad faith and untruth of an answer begotten from the suppression or failure to produce the proof ordered, when such proof concerned the rightful decision of the cause. * * * [P]reservation of due process was secured by the presumption that the refusal to produce evidence material to the administration of due process was but an admission of the want of merit in the asserted defense." (212 U. S. at 350-351)*

The explicit language of Fed. R. Civ. P. 37 (quoted at Toolco Br., pp. 9a-11a) incorporates the *Hammond* rule and specifically enables a District Court to secure compliance with and thereby effectuate the discovery provisions of the Federal Rules. In applying the broad array of sanctions provided by Rule 37 a district judge, particularly one assigned to a case for all purposes, is vested with broad discretion to make whatever disposition is just on the facts and circumstances of the case before him.

The evidence sought by the Hughes deposition and the categories of documents more than simply "concerned the rightful decision of the cause". Involving as it did the activities of Hughes, either personally or through his lawyer agents, and the tax factors which motivated Hughes, it went to the heart of the case. Toolco deliberately prevented disclosure of that evidence. Surely that refusal to make disclosure of facts bearing so heavily on the validity of Toolco's claims raises more than an ample presumption as to the lack of merit of those claims. That refusal to comply with the discovery orders was all the more reprehensible because, as the Court of Appeals found, it was so obviously

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* The only exceptions to the *Hammond* rule are when the sanction of dismissal has been applied as punishment (*Hovey* v. *Elliott*, 167 U. S. 409 (1897)), or where the failure to make discovery was not wilful or deliberate (*Societe Internationale* v. *Rogers*, 357 U. S. 197 (1958)). Neither of those exceptions has any applicability here.

a tactic designed "to frustrate the implementation of the discovery machinery devised by the federal judiciary to expedite the handling of such complex litigation" (R. 1435).

Under circumstances not nearly as flagrant as those in the case at bar, the lower courts have repeatedly dismissed complaints with prejudice or entered default judgments. *Pioche Mines Consolidated, Inc.* v. *Dolman*, 333 F. 2d 257 (9th Cir. 1964); *Nasser* v. *Isthmian Lines*, 331 F. 2d 124 (2d Cir. 1964); *Von Der Heydt* v. *Kennedy*, 299 F. 2d 459 (D. C. Cir.), *cert. denied*, 370 U. S. 916 (1962); *Bourgeois* v. *El Paso Natural Gas Co.*, 257 F. 2d 807 (2d Cir. 1958); *First Iowa Hydro Elec. Cooperative* v. *Iowa-Illinois Gas & Elec. Co.*, 245 F. 2d 613 (8th Cir.), *cert. denied*, 355 U. S. 871 (1957); *Hubbard* v. *Baltimore & O. R.R.*, 249 F. 2d 885 (6th Cir. 1957); *Mooney* v. *Central Motor Lines*, 222 F. 2d 569 (6th Cir. 1955); *Fischer* v. *Dover S.S. Co.*, 218 F. 2d 682 (2d Cir. 1955); *Delphy* v. *Bernuth, Lembcke Co.*, 217 F. 2d 301 (2d Cir. 1954); *Peitzman* v. *City of Illmo*, 141 F. 2d 956 (8th Cir.), *cert. denied*, 323 U. S. 718 (1944); *Collins* v. *Wayland*, 139 F. 2d 677 (9th Cir.), *cert. denied*, 322 U. S. 744 (1944).

B. The District Court was also required to dismiss the counterclaims for Toolco's refusal to prosecute.

Toolco's counterclaims were also properly dismissed under this Court's decision in *Link* v. *Wabash R. R.*, 370 U. S. 626 (1962). The motion of the Additional Defendants to dismiss the counterclaims was predicated not only on Toolco's refusal to make discovery but also on Rules 41(b) and 41(c) (quoted at Toolco Br., pp. 12a-13a) by reason of Toolco's refusal to prosecute (R-205).* As this Court has

* The Court of Appeals did not consider whether affirmance of the District Court's judgment was supportable under Rules 41(b) and (c). However, the Court of Appeals did refer to *Link* v. *Wabash R.R.* as support for its affirmance (R. 1434).

recently held, "the authority of a federal trial court to dismiss a plaintiff's action with prejudice because of his failure to prosecute cannot seriously be doubted" (370 U. S. at 629).

On the record presented in *Link* v. *Wabash R. R.*, the Court affirmed dismissal of the plaintiff's complaint with prejudice, although it was allegedly meritorious, because of the dilatory prosecution of that action by plaintiff's counsel and because of plaintiff's counsel's failure to comply with pre-trial orders of the Court. Dismissal there had been entered *sua sponte* and without a hearing.

In the case at bar, Toolco not only failed, but deliberately refused, to prosecute the action which it had brought against the Additional Defendants. As a "business decision" it made an express election "to rest on the merits of its positions as heretofore taken" (see pp. 30-33, *supra*). It did so after consultation between attorney and client, and "fully aware of the sanctions which the Court, in its discretion, may impose" because of its decision "not to proceed any further with respect to discovery proceedings".* The District Court gave ample notice that a dismissal with prejudice would be the inevitable result of Toolco's refusal to prosecute (see pp. 32-33, *supra*). That ample notice incorporated the "basic constitutional requirements of fairness" into the proceedings below. *Link* v. *Wabash R. R.*, 370 U. S. at 648 (dissenting opinion).

In this case, Toolco's refusal to prosecute was far more grievous and under far more aggravating circumstances than was the conduct of the plaintiff in *Link* v. *Wabash R.R.* Again, in situations far less compelling, the lower courts have often dismissed with prejudice for failure to prosecute. See cases cited in *Link* v. *Wabash R.R.*, 370 U. S. at 631 nn. 4 and 5; and cases cited in 5 Moore, Federal Practice ¶ 41.11(2) (2d Ed. 1964).

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* Thus on February 21, 1963, Toolco's counsel told the District Court that Toolco had made "a wilful decision. It was and is a deliberate decision, fully aware of the risks involved" (B-434).

C. Petitioner's present contention that, despite its repeated contrary statements, a voluntary dismissal should nevertheless have been granted by the District Court is without merit.

Petitioner states in its brief that the District Court "should have considered whether a dismissal without prejudice ('non-suit') was appropriate" (Toolco Br., p. 53).

The first and complete answer to that contention is that not only did Toolco not seek such relief below, but its counsel expressly told the District Court on three different occasions that it was not seeking a voluntary dismissal.

> (1) At the pre-trial hearing on February 8, 1963, Toolco's counsel stated: "*Mr. Davis*: On the counterclaims, your Honor, as your Honor will recall, I have a motion pending to stay—*not to dismiss but to stay*—those counterclaims until after a determination has been made by the CAB. * * * " (AA-174).
>
> (2) In an affidavit dated February 21, 1963, filed in opposition to the additional defendants' motion for a dismissal of the counterclaims with prejudice, Chester C. Davis stated: "*Rather than seeking a voluntary dismissal without prejudice* * * * it [Toolco] sought a stay of further proceedings. * * * " (f. 5022).
>
> (3) In a brief dated April 29, 1963, filed in opposition to the same motion Toolco's counsel again stated: "*Rather than seeking a voluntary dismissal*, which it believes the Court would have been obligated to grant, Toolco sought a stay. * * * " (f. 5129).

Ignoring the record below, Petitioner now asserts three reasons why the District Court should have granted a voluntary dismissal (Toolco Br., pp. 55-67).

The first reason asserted is "the probable merit of Toolco's counterclaims" (Toolco Br., p. 56). In support

of that argument Toolco cites three groups of "admitted or hardly disputable facts" (Toolco Br., p. 56). The first such group of facts relates to the alleged "dominant position of Equitable and Metropolitan in the supplying of senior long-term equipment financing to the major airlines of the United States" (Toolco Br., p. 56). However, both Equitable and Metropolitan denied those allegations of the counterclaims (compare AA-50-51 with B-67 and B-93). The second group of facts relates to allegations concerning TWA "being engrossed as a 'captive market'." Again, the Additional Defendants denied those allegations (compare AA-59 with, *e.g.*, B-71 and B-97). The third group of such facts relates to the alleged interlocks between Metropolitan and Pan American World Airways (Toolco Br., pp. 56-57). Those alleged facts are not even contained in Toolco's counterclaims.

The Court must view even those specious claims of merit in the light of Toolco's refusal to make discovery which the Additional Defendants assert would have exposed the counterclaims as unsupportable. The facts here illustrate the correctness of this Court's decision in *Hammond Packing* that when a party refuses to make discovery a valid presumption of lack of merit arises.

The second reason asserted by Toolco why it should have been granted a voluntary dismissal is the "procedural posture of the case" (Toolco Br., p. 58). The argument here is twofold. Toolco first makes an argument on the basis of the "procedural posture" which would have existed if the Additional Defendants had not filed replies to the counterclaims prior to February 8, 1963. The simple answer here is that the Additional Defendants, with the exception of Tillinghast, did file replies prior to February 8, 1963 (B-61, B-87, B-112, B-149, B-196).*

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* When Tillinghast replied to the counterclaims on February 11, 1963, Toolco still denied that it sought a voluntary dismissal without prejudice (p. 42, *supra*).

As additional support for its second reason, Toolco claims that the Additional Defendants suffered "no prejudice whatever" because of Toolco's actions (Toolco Br., p. 59). Toolco asserts that whatever burdens the Additional Defendants may have suffered in connection with discovery were "gratuitously assumed" (Toolco Br., p. 61, n. 8). As shown above at pages 21 to 24, that statement is a flagrant distortion of the record below. A vivid demonstration of the burdens placed upon the Additional Defendants is that they were required, at Toolco's urging, to pay two-thirds of the Special Master's fee for presiding over all of the depositions taken by Toolco (B-32).

In addition to the many hundreds of thousands of dollars which the Additional Defendants were required to spend in defense of the counterclaims (B-210, B-275, B-280-281, B-283), the Additional Defendants were deliberately and unnecessarily led to expend many thousands of dollars to prepare for the deposition of Hughes (B-210). Because of the tremendous expense involved in transferring their entire files and setting up a special office in Los Angeles to take Hughes' deposition (B-210, f. 2505), the Additional Defendants began to press Toolco to reveal its intentions with respect to the Hughes deposition in early January (*e.g.*, B-314). The District Court even ordered Toolco's counsel to advise all parties by January 22, 1963, regarding its plans for the Hughes deposition (AA-121). Toolco, however, as late as January 23, 1963 refused to "address itself to whatever problems, if any, exist with respect to the availability of Mr. Hughes at any particular time" until it finally refused to produce him three days before the scheduled deposition (B-229). In view of Toolco's ultimate refusal to proceed, all of the many thousands of dollars expended by the Additional Defendants to prepare to examine Hughes were entirely wasted.

Too much time, money and effort have been expended by the Additional Defendants in the defense of the counterclaims and in an attempt to reveal the facts for Toolco now to be heard to claim that no prejudice has resulted to them "by reason of the pendency of the counterclaims" (Toolco

Br., p. 59). See *Costello* v. *United States*, 365 U. S. 265, 286-87 (1961); *Shaffer* v. *Evans*, 263 F. 2d 134 (10th Cir. 1958), *cert. denied*, 359 U. S. 990 (1959); *Piedmont Interstate Fair Ass'n* v. *Bean*, 209 F. 2d 942 (4th Cir. 1954); *Harvey Aluminum, Inc.* v. *American Cyanamid Co.*, 203 F. 2d 105 (2d Cir. 1953); *Walker* v. *Spencer*, 123 F. 2d 347 (10th Cir.), *cert. denied*, 316 U. S. 692 (1941); *Olsen* v. *Muskegon Piston Ring Co.*, 117 F. 2d 163 (6th Cir. 1941).

The third reason which Toolco now asserts why the District Court should have granted a voluntary dismissal is "the justification for the suspension of litigation on the counterclaims" (Toolco Br., p. 62). Toolco asserts here that because it believed its interpretation of *Panagra* was correct and the District Court's interpretation erroneous, it was entitled unilaterally to grant itself a stay of prosecution of its counterclaims.

In other words, Toolco apparently believes itself entitled to operate under a private code of procedure regardless of the rulings made by the District Court. Moreover, Toolco necessarily must claim that, under its private code, an *ex post facto* effect should be given to its announced determination to abandon the counterclaims. Only with such an effect could the alleged decision to abandon because of *Panagra*—announced for the first time to the Court on February 8, 1963—be stretched backward to blot out the repeated previous refusals to produce documents—made on January 14, 1963 (B-221-223), January 23, 1963 (B-224-226), and February 1, 1963 (AA-144, B-248-251, B-177). Obviously, that position is untenable.*

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* Toolco misstates the record when it now claims that its "failure to proceed—and its consequent failure to make discovery—arose out of its affirmative decision to suspend prosecution of its counterclaims, based on its view of the *Panagra* case * * *" (Toolco Br., p. 29). Toolco's initial default, on January 14, 1963, occurred before its counsel had even heard of this Court's *Panagra* decision, and its defaults of January 23 and February 1, 1963 were not defended by reference to *Panagra*.

As shown in Point II hereof, Toolco's position with respect to *Panagra* was wrong. In the view of the Additional Defendants, Toolco's position was so obviously wrong that its "belief" cannot even be said to have been a reasonable one. Toolco's alleged belief in the righteousness of its cause is totally inconsistent with the record in the court below. The District Court found that Toolco's decision to bring on the motion to dismiss the complaint, after it had been pending for more than a year and a half, was simply "another attempt to put off the deposition of Hughes" (AA-119). So, likewise, Toolco's CAB complaint and its motion to stay prosecution of the counterclaims was simply another attempt to put off the deposition of Hughes. The stay motion was a calculated attempt to avoid discovery. When that maneuver failed, Toolco quit rather than reveal the facts.

Moreover, even if Toolco's alleged belief had been reasonable, it would not justify refusal to comply with the Court's orders relating to discovery, nor would it justify a refusal to prosecute. In *Hammond Packing Co.* v. *Arkansas,* the Court stated:

> "As the Hammond Company absolutely declined to obey the order and stood upon what it deemed to be its lawful rights and privileges, even if that course of conduct was taken because of a contrary conception as to the meaning of the statute, it is not within our province to afford relief because of an error of judgment in this respect." (212 U. S. at 347)

Finally, in refusing to proceed, because of "the position of Toolco that it may not be properly subjected to further discovery proceedings by * * * the additional defendants at this time", Toolco's counsel specifically recognized that "should it develop that they are in error" Toolco might be deprived of any further opportunity to litigate in the District Court, "other than on the question of damages" to which TWA was entitled (see pp. 31-32,

supra). Having acted with its eyes open, Toolco cannot now complain of the consequences if its legal theories based on *Panagra* are rejected.

POINT II

The Court of Appeals correctly concluded that the District Court was not ousted of jurisdiction over the counterclaims by virtue of this Court's decision in *Panagra*.

Toolco contends on this appeal that a dismissal with prejudice was error because "this Court's decision in *Panagra* precluded the present prosecution of its counterclaims" (Toolco Br., p. 27). We have demonstrated that in filing the CAB complaint and moving for a stay below, allegedly on the basis of *Panagra*, Toolco was simply attempting to avoid discovery. Not only was that motion so motivated, but the basis therefor was entirely without merit.

Toolco no longer contends that a stay would have been proper. Rather, on this appeal Toolco argues, for the first time, that the District Court had no jurisdiction over the counterclaims, and that they should have been dismissed without prejudice. That position likewise is untenable.

A. The arguments on which Toolco relies in No. 443 have no bearing whatsoever on this appeal.

In its brief on the merits, as well as in its petition for certiorari, Toolco has repeatedly sought to create the impression that the legal issues regarding the meaning and effect of *Panagra* and the interpretation of the Federal Aviation Act which it has advanced in No. 443 are equally applicable and hence would govern the decision here. However, there are fundamental differences between the appli-

cation of *Panagra* and this Act to the matters presented in No. 443 and to those presented on this appeal.

(1) *No CAB orders comparable to those involved in No. 443 have been issued with respect to the Additional Defendants.*

As pointed out in Toolco's brief in No. 443, the CAB found Toolco to be engaged in a phase of aeronautics, held hearings and approved Toolco's acquisition of control of TWA in 1944 and again in 1950. The CAB conditioned that approval upon a limitation which it placed on transactions between Toolco and TWA. Thereafter, transactions exceeding that limitation were submitted to and allegedly approved by the CAB in a series of orders. Toolco's contention in No. 443 is that those orders have exempted Toolco from liability for the antitrust violations alleged in the complaint. We believe that there is no such exemption. However, an issue is presented in No. 443 as to what effect should be accorded to those several CAB orders.

But so far as the counterclaims are concerned, no such issue exists. The CAB has never found that any of the Additional Defendants are engaged in a phase of aeronautics, it has never found that any of them have acquired control of TWA, and it has never issued any similar orders under Section 408 as to the relationship between TWA and the Additional Defendants. Indeed, the basis of Toolco's entire argument on this appeal is that the lending institutions assumed control of TWA unlawfully, because they did not apply for and obtain such orders.

While there is no contention by any party, including Toolco, that the CAB has heretofore entered any orders which exempt the Additional Defendants from the antitrust laws, the only relevant order which the CAB has entered, that of December 29, 1960 (B-470), undermines Toolco's entire position.

In December 1960 Toolco, TWA and the lending institutions entered into a series of agreements for the financing of TWA's jet equipment, which included the establishment of the voting trust. Under the existing control orders it was necessary for TWA and Toolco, who were concededly under the jurisdiction of the CAB, to submit those agreements to the CAB before they could be consummated. Accordingly, TWA, then under the control of Toolco, filed a petition with the CAB requesting it to give "approval under Section 408, * * * if necessary, for the transactions contemplated under the financing plan," including the voting trust agreement (B-471).

The CAB specifically recognized that as a result of the voting trust, "a significant and fundamental change will have been accomplished in the control of TWA by Toolco," and that "no longer will the directors of Toolco be free to enforce their dictates or those of Toolco's controlling shareholder on TWA" (B-475). Referring to the financial difficulties and the delays in obtaining flight equipment which TWA had suffered under Toolco's control, the CAB concluded that transfer of control to the voting trustees would be consistent with the public interest (B-478-479).

If the CAB, having knowledge of the facts, had thought that control of TWA was being acquired by persons engaged in a phase of aeronautics, clearly it would have required such persons to file an application under Section 408(b). Moreover, if there had been any question that the public interest would not be served, the CAB would surely have satisfied itself as to such matters before granting approval. However, the Board took no such action, although expressly requested to give any approval under Section 408 which might be necessary. Plainly, therefore, there was no impediment to the right of the lending institutions to carry out the terms of the voting trust agreement.

Toolco's argument boils down to the preposterous proposition that it was unlawful for the lending institutions to carry out the terms of the voting trust agreement without an express order of the CAB under Section 408, even though the CAB had already issued an order under Section 408 expressly authorizing the consummation thereof.

(2) *In No. 443 Toolco invokes* Panagra *in its own defense, while here it urges that* Panagra *is a defense for its adversaries.*

In No. 443, Toolco, as a party charged by TWA with antitrust violations, is taking the position that, under *Panagra*, and as a result of orders previously entered by the CAB, it has been exempted from liability. In this appeal Toolco, as a party complaining that *others* have committed antitrust violations, is taking the position that, under *Panagra*, the Additional Defendants may be exempted from liability by future CAB orders. Accordingly, Toolco contends that the District Court lacks jurisdiction to adjudicate Toolco's own counterclaims unless the CAB has expressly refused to grant any such exemption.

Toolco's remarkable conduct in basing this appeal on the existence of a possible defense for its adversaries, which they have never sought to assert, is understandable only by considering the context in which it injected *Panagra* as an issue with respect to the counterclaims. After the *Panagra* decision came down, it is apparent that Toolco gave it careful study to see if it furnished any basis at all for not proceeding with the imminent deposition of Hughes. So far as the TWA complaint was concerned, Toolco, as a defendant accused of antitrust violations, could incorporate *Panagra* in its pending motion to dismiss and argue that this decision exempted it from liability.

But what about the counterclaims? For Toolco was under orders of the Court to proceed with discovery as to the counterclaims as well as the complaint. As things

stood, it made no difference, as far as the issues raised by the counterclaims were concerned, whether Toolco's position in regard to the complaint was sustained or not. The issue under the counterclaims was a simple factual one: Was it Hughes and Toolco, or the banks and insurance companies, which caused the injury to TWA? It would be a complete defense to the Additional Defendants under the counterclaims to show that the damage was caused by Hughes and Toolco, regardless of whether the latters' conduct was exempted. So also as to the corollary: Toolco could still prevail on its counterclaims if it could prove that the Additional Defendants had caused the damage in question, regardless of whether Toolco's conduct was exempted. Thus the issues it had raised as to the complaint could have no bearing whatever on the counterclaims.

Accordingly, as matters stood when *Panagra* was decided, there was no basis whatsoever for Toolco's refusal to continue prosecution of its counterclaims. How then could Toolco manufacture a situation which might give it some kind of excuse for defying the orders of the Court directing discovery?

The only way was to contrive to bring the counterclaims under the umbrella of the theories regarding *Panagra* which it was advancing as a defense to the complaint. Accordingly, it filed a complaint with the CAB alleging that some of the Additional Defendants had obtained control of TWA in violation of Section 408.

But how would this help Toolco on the counterclaims? In the first place, for the CAB to find the Section 408 violation alleged by Toolco, it would have to hold retroactively that it had been unlawful for the lending institutions to consummate the voting trust agreement, even though they were relying upon the express approval, as in the public interest, which the CAB itself had given that agreement in 1960.

Moreover, even in the unlikely event that the CAB should assume jurisdiction, and then hold retroactively that the alleged acquisition of control in 1960 had been both unlawful and against the public interest,* Toolco would still have no basis for refusing to continue to prosecute the counterclaims. For, as Toolco itself concedes (Toolco Br., p. 48), it could, under these circumstances, prevail on its counterclaims if it established that the Additional Defendants had caused the delays and consequent damage to TWA. Similarly, as Toolco also concedes (Toolco Br., pp. 47-48), if the CAB should reject Toolco's contention that the lending institutions were engaged in a phase of aeronautics and dismiss the complaint for lack of jurisdiction, the rights of the parties under the counterclaims would be completely unaffected. Thus neither the granting of the relief sought nor the rejection of its complaint would affect the right of Toolco to prosecute its counterclaims in any way.

However, in a desperate effort to find some basis for defending a deliberate and wilful refusal to comply with discovery orders, Toolco has advanced the extraordinary argument that perhaps it was wrong after all—or at least half wrong—in the contentions it had raised in its complaint before the CAB. It might be that the CAB would agree that the banks and insurance companies were engaged in a phase of aeronautics and it might be that the CAB would also find that they had assumed control unlawfully in 1960. However, it might be that the CAB would then disagree with Toolco's contention that the acquisition and exercise of such control were against the public interest.** Then, in that most uncertain event, Toolco contends that

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* Which the Bureau of Enforcement of the CAB has already recommended it should not do (see p. 65, *infra*).

** Technically, Toolco's complaint could not possibly lead to this result unless the Additional Defendants saw fit to file an application under Section 408(b) which refers only to applications "seeking approval" of an acquisition of control.

it fears the Additional Defendants would have a defense to the counterclaims similar to that which Toolco claims it has to the complaint in No. 443: that the order of the CAB would exempt the Additional Defendants from liability for the acts alleged in the counterclaims. Accordingly, so goes the argument, on the basis of its contentions in No. 443, Toolco should not be compelled to proceed with the prosecution of its counterclaims until these fears have been put at rest.

Thus, Toolco has deliberately set in motion a complicated and very confusing and uncertain train of events in another jurisdiction which might go awry, from Toolco's standpoint, and thus give the Additional Defendants a tenuous and very speculative defense to Toolco's own counterclaims. Therefore, Toolco now says it should have been excused from obeying the orders of the District Court until all the doubtful and frequently frivolous issues which Toolco had attempted to raise had been resolved. As the District Court put it when it heard this argument, what Toolco wants is a chance to go "down to Washington to see if what we claim is wrong is really all right." (AA-178)

If there were any merit whatsoever to Toolco's assertions, the Additional Defendants would themselves have sought a dismissal of the counterclaims, and taken action in the CAB to secure the immunity which Toolco says is available to them. In view of the comments by the CAB in its December 29, 1960 order as to the mismanagement of TWA by Toolco (B-475-478), the Additional Defendants would have had every reason to believe that the Board would have formally approved as in the public interest their alleged acquisition of control of TWA, and thus the immunity to which Toolco refers would follow. But as we shall demonstrate, even if the series of events allegedly feared by Toolco should take place, no orders that the CAB could issue relating to the control of TWA by the

Additional Defendants—even assuming that the Additional Defendants were found to be engaged in a phase of aeronautics—could in any way provide a defense under *Panagra* to the wrongs complained of by Toolco.

It seems clear that if the grounds advanced by Toolco as an excuse for its deliberate and repeated defaults should be sustained, any litigant could evade its duty to continue any litigation brought by it, whenever it suited its convenience to do so. A litigant could do that by the simple device of alleging on whatever flimsy ground it chose, that some part of the controversy it had brought before the court should be considered by some administrative agency, and that the proceedings before the court should be stayed, or dismissed without prejudice, until the agency itself determined whether or not the party's "position" had any merit. Surely, such a principle would make a shambles of both the judicial and the administrative process.

(3) *In No. 443, Toolco argues that the CAB has exempted its conduct prospectively; here Toolco contends the CAB might exempt past conduct by the Additional Defendants.*

In No. 443 Toolco contends that the CAB exempted Toolco's conduct in the exercise of control of TWA. In this case Toolco argues that the CAB might exempt conduct of the Additional Defendants prior to their alleged assumption of control. Toolco's counterclaims allege misconduct by the Additional Defendants both before and after December 1960, when the voting trust was effected. The principal antitrust violation pleaded—to restrain competition in financing air carriers—is alleged to have commenced "prior to 1956" (AA-57).

In No. 443, Toolco contends that the CAB necessarily has the power to sanction Toolco's exercise of control of TWA and that the CAB has used that power. Whatever may be the result of that argument, and we think it is

erroneous, it does not help Toolco's impossible contention here that the CAB might somehow approve and exempt, *inter alia*, alleged antitrust violations which occurred at least four years before there existed any matter which even Toolco would now say should have been submitted to the CAB in 1960.

B. Toolco's contentions that the District Court lacked jurisdiction over the counterclaims are refuted by the decisions of this Court and the provisions of the Federal Aviation Act.

Toolco's present position as to the effect of *Panagra* is that "the District Court should have *dismissed* all the counterclaims for want of jurisdiction, without prejudice to their reinstitution, if appropriate, after action by the Board * * *" (Toolco Br., p. 28). Thus, Toolco now concedes that the *stay* which it requested in the District Court on February 6, 1963, and supported in the Court of Appeals (R. 1431) and in its petition for certiorari (Pet. for Cert., p. 24), should not have been granted. It is not surprising that Toolco has at last abandoned its defense of a stay, since the District Court, on the basis of the record below, clearly was correct in refusing to grant such discretionary relief. See *Landis* v. *North American Co.*, 299 U. S. 248, 254-55 (1936). Of course, the dismissal which Toolco now seeks is precisely what it told the District Court three times it did not want (see p. 42, *supra*).

Toolco now takes the position that the District Court was powerless to entertain the counterclaims, even to the limited extent of permitting pre-trial discovery to proceed, since they initially fell in their entirety within the exclusive ambit of the CAB. It argues that no court can entertain any private action, "under the antitrust laws or otherwise," that involves in any way a control relationship between an air carrier and a person *allegedly* engaged in a phase of aeronautics, until the CAB has first considered and "declined to sanction" the conduct in question (Toolco

Br., p. 36). Toolco thus contends that the CAB can abolish private actions "under the antitrust laws or otherwise" in spite of Section 1106 of the Federal Aviation Act, which carefully preserves private rights and remedies from alteration or abridgement by that Act. We submit that Toolco's view as to the breadth of jurisdiction of a regulatory agency goes far beyond any decision of this Court, and violates basic jurisdictional tenets which this Court has repeatedly endorsed.

The only authority upon which Toolco relies to support this theory is the *Panagra* decision, which rejects any such doctrine. In *Panagra* this Court considered whether the CAB, in regulating the air transportation industry under the Federal Aviation Act, or the Department of Justice, in discharging its responsibilities under the antitrust laws, was the proper government agency to deal with problems lying "within the purview of the Board," such as "questions of division of territories, the allocation of routes, and the affiliation of common carriers with air carriers." In sum, *Panagra* had nothing to do with the rights of private parties.

The Court there reviewed the legislative history of the predecessor of the Federal Aviation Act, observing:

> "No mention is made of the Department of Justice and its role in the enforcement of the antitrust laws, yet *we hesitate here, as in comparable situations,*[9] *to hold that the new regulatory scheme*

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[9] *Cf. Georgia* v. *Pennsylvania R. Co.*, 324 U. S. 439, holding that the Interstate Commerce Act is no bar to an antitrust suit against a carrier; *United States* v. *R.C.A.*, 358 U. S. 334, holding that the Federal Communications Act is no bar to an antitrust suit against TV and radio licensees; *United States* v. *Borden Co.*, 308 U. S. 188, 195-199, holding that neither the Agricultural Adjustment Act nor the Capper-Volstead Act displaced the Sherman Act; and *California* v. *Federal Power Comm'n*, 369 U. S. 482, holding that the Clayton Act was not displaced by the Natural Gas Act. And see *Milk Producers Assn.* v. *United States*, 362 U. S. 458."

adopted in 1938 was designed completely to displace the antitrust laws—absent an unequivocally declared congressional purpose so to do. While the Board is empowered to deal with numerous aspects of what are normally thought of as antitrust problems, *those expressly entrusted to it encompass only a fraction of the total.* Apart from orders which give immunity from the antitrust laws by reason of § 414, the whole criminal law enforcement problem remains unaffected by the Act. Cf. *United States* v. *Pacific & Arctic Co.*, 228 U. S. 87, 105. Moreover, on the civil side violations of antitrust laws other than those enumerated in the Act might be imagined. *We, therefore, refuse to hold that there are no antitrust violations left to the Department of Justice to enforce.*

That does not, however, end our inquiry. Limitation of routes and divisions of territories and the relation of common carriers to air carriers are *basic in this regulatory scheme.* The acts charged in this civil suit as antitrust violations are *precise ingredients* of the Board's authority in granting, qualifying or denying certificates to air carriers, in modifying, suspending or revoking them, and in allowing or disallowing affiliations between common carriers and air carriers." (371 U. S. at 304-05)

The Court went on to say:

"* * * The Board has no power to award damages or to bring criminal prosecutions. *Nor does it, as already noted, have jurisdiction over every antitrust violation by air carriers.* But where the problem lies within the purview of the Board, as do questions of division of territories, the allocation of routes, and the affiliation of common carriers with air carriers, Congress must have intended to give it authority that was ample to deal with the evil at hand." (371 U. S. at 311-12)

* * *

"We think *the narrow questions* presented by this complaint have been entrusted to the Board and that the complaint should have been dismissed." (371 U. S. at 313)

In the dissenting opinion in *Panagra*, Mr. Justice Brennan, joined by the Chief Justice, stated that "the scheme of the Aeronautics Act refutes any inference that *pro tanto* repeal of the antitrust laws was intended," and also noted that even "to apply the doctrine of primary jurisdiction to the case at bar would be somewhat of an extension of our decisions in the area, so zealously have we guarded the obligation of judicial enforcement of the antitrust laws" (371 U. S. at 321, 332).

It is apparent from a mere inspection of Toolco's counterclaims (AA-40-84), that they do not conceivably fall within that "fraction of the total" of antitrust problems entrusted to the CAB nor do they, in any sense, constitute "precise ingredients" of the Board's regulatory authority.

Those counterclaims—seeking $366,000,000 in damages—are directed, not against air carriers, but against a group of financial institutions and their officers. They allege common law claims, such as breach of contract (AA-48-49), breach of fiduciary duty (AA-48-49) and conspiracy to inflict malicious injury on Toolco and Hughes (AA-78); claims based upon a violation of a state statute as to the life of a voting trust (AA-79); and such garden-variety antitrust claims as price-fixing (AA-55), allocation of customers (AA-55), boycott (AA-55) and conspiracy to monopolize the supplying of financing to air carriers (AA-54-55).

In none of these charges is Toolco "raising issues of fact not within the conventional experience of judges." *Far East Conference* v. *United States*, 342 U. S. 570, 574 (1952). Nor was intervention of the CAB necessary here in order to obtain "uniformity and consistency in the regulation of business" by an agency with "specialized competence." See *Far East Conference* v. *United States*, *supra*; *Federal Maritime Board* v. *Isbrandtsen Co.*, 356 U. S. 481, 497-99 (1958). The CAB has no regulatory jurisdiction over the insurance or banking industries.

In fact, Congress has consistently refused to empower it to regulate financing by air carriers (see p. 66, *infra*). Thus the subject matter of Toolco's counterclaims presents a far different situation than confronted this Court in *Panagra*, where the Court was concerned with matters such as the allocation of routes, which were held to fall squarely within the scope of the Board's expertise.* We submit that the Court of Appeals was correct in concluding the counterclaims "fall beyond the scope of the CAB's exclusive jurisdiction," as "they deal with alleged misconduct on the part of the lending institutions in their dealings with TWA and Toolco and in no respect with matters specifically entrusted to the Board in the Act" (R. 1432).

In order to bolster its argument that there has been a "supersession of the antitrust laws by a regulatory regime" (Toolco Br., p. 47 n. 13), Toolco contends that if the CAB now approved the alleged acquisition of control of TWA by the lending institutions, the Additional Defendants would be exempted, under Section 414 of the Act, from liability for the past antitrust violations and common law wrongs charged by Toolco in its counterclaims.

Section 414 reads in its entirety as follows:

> "Any person affected by any order made under sections 1378 [408], 1379 [409], or 1382 [412] of this title shall be, and is hereby, relieved from the operations of the 'antitrust laws', as designated in section 12 of Title 15, and of all other restraints or prohibitions made by, or imposed under, authority of law, insofar as may be necessary to enable such person to do anything authorized, approved, or re-

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* *Cf. Whitney National Bank* v. *Bank of New Orleans & Trust Co.*, 85 S. Ct. 551 (1965), where the issues there involved were held to be "the very types of questions that Congress has committed to the [Federal Reserve] Board," and the situation was one where "Congress has provided statutory review procedures designed to permit agency expertise to be brought to bear on particular problems." (85 S. Ct. at 557-58)

quired by such order." 72 Stat. 770, 49 U. S. C. § 1384 (1958).

Clearly, that section deals only with acts taken after the entry of an order.

Section 408 of the Act is the only section referred to in Section 414 which Toolco contends gives the CAB power to approve the alleged wrongs. It provides in relevant part that "it shall be unlawful unless approved by order of the Board as provided in this section * * * for any * * * person engaged in any * * * phase of aeronautics to acquire control of any carrier in any manner whatsoever." The section further provides that such approval shall be given "unless, after * * * hearing, the Board finds that the * * * acquisition of control will not be consistent with the public interest or that the conditions of this section will not be fulfilled * * *."

Toolco fails to demonstrate that a CAB order under Section 408, approving the acquisition of control of TWA by the Additional Defendants, could possibly have the effect of exempting them retroactively from liability for the damage which they allegedly caused TWA and Toolco *prior* to such order. All that the CAB could approve under Section 408 would be the fact of acquisition, which would be found to be in the *public* interest. The *private* wrongs which Toolco alleges were perpetrated by the Additional Defendants by the manner in which they purportedly obtained, exercised and perpetuated control over TWA could still be asserted by Toolco as a basis for imposing civil liability on the Additional Defendants in a private action.

Of course, Section 414 grants an exemption only for acts taken after the entry of an order, and only "*insofar as may be necessary to enable such person to do anything authorized, approved, or required by such order.*" Surely all the grievous injuries allegedly inflicted on TWA by the Additional Defendants as a result of their activities

for many years before and after the establishment of the voting trust agreement would not be "necessary" to do what was "authorized, approved, or required" by a CAB order entered now upholding the acquisition of control as not inconsistent with the public interest.

It is also significant that Toolco has chosen to ignore Section 1106 of the Federal Aviation Act, providing as follows:

> "Nothing contained in this chapter shall in any way abridge or alter the remedies now existing at common law or by statute, but the provisions of this chapter are in addition to such remedies." 72 Stat. 798, 49 U. S. C. § 1506 (1958).

Despite this provision, Toolco urges that Section 414 must be interpreted as giving the CAB power literally to abolish private actions, whether based on the common law or the antitrust laws. Such an argument would have the effect of striking Section 1106 out of the Act. It also flies in the face of a long line of decisions of this Court holding that "immunity from the antitrust laws is not lightly implied." See *e.g.*, *United States* v. *Philadelphia Nat'l Bank*, 374 U. S. 321, 348 (1963); *California* v. *Federal Power Commission*, 369 U. S. 482, 485 (1962); *Georgia* v. *Pennsylvania R. R.*, 324 U. S. 439, 456-57 (1945). As this Court recently observed in *United States* v. *Philadelphia Nat'l Bank, supra*:

> "* * * Repeals of the antitrust laws by implication from a regulatory statute are strongly disfavored, and have only been found in cases of plain repugnancy between the antitrust and regulatory provisions." (374 U. S. at 350-51)
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> * * *
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> "* * * Furthermore, the considerations that militate against finding a repeal of the antitrust laws by implication from the existence of a regulatory scheme also argue persuasively against attenuating, by postponing, the courts' jurisdiction to enforce those laws." (374 U. S. at 354)

Many of the antitrust violations alleged by Toolco, such as the purported conspiracy to monopolize, and divide the market for, financing to airlines, as well as the purported conspiracy to cut off TWA from alternative sources of funds and to fix the interest rates to be charged TWA, are not predicated upon the claimed acquisition or exercise of control over TWA by the Additional Defendants. Those claims stand independently of any such acquisition or exercise. In addition, they relate to conduct preceding the December 1960 establishment of the voting trust (*i.e.*, the date of the alleged acquisition of control) by months, and, in some cases, years (see AA-57, AA-59).

With respect to those allegedly illegal acts occurring *after* the execution of the voting trust agreement, Toolco is in error in contending that such acts, even if constituting an *exercise* of control, could now be immunized from liability by CAB action pursuant to Section 408. That section, of course, only gives the CAB power to approve an *acquisition* of control as not inconsistent with the public interest; it does not refer to the *exercise* of control at all. Concededly, the CAB, by conditioning or modifying its order approving an acquisition of control, has the power to terminate the control relationship on the basis of acts committed in the exercise of that control. But we know of no authority, and Toolco has cited none, in support of the proposition that the CAB, acting pursuant to Section 408, could retroactively exempt those parties allegedly controlling TWA from liability for breach of contract with Toolco and for classic acts of mismanagement already committed in the exercise of control, which are alleged, *e.g.*, in the first counterclaim (AA-40).

As support for its position that "jurisdiction over the subject matter of the counterclaims was confided to the Civil Aeronautics Board" (Toolco Br., p. 3), Toolco also relies on Section 411 of the Federal Aviation Act (49 U. S. C. § 1381) (see Toolco Br., pp. 44-45). But this section simply gives the Board power to determine:

> "* * * whether any air carrier, foreign air carrier, or ticket agent has been or is engaged in unfair or deceptive practices or unfair methods of competition in air transportation or the sale thereof."

None of these respondents is an "air carrier, foreign air carrier, or ticket agent," and the counterclaims do not relate to practices or methods of competition "in air transportation or the sale thereof." Moreover in *Panagra*, this Court observed that "the words 'unfair * * * practices' and 'unfair methods of competition' as used in § 411 * * * *do not embrace a remedy for private wrongs* but only a means of vindicating the public interest" (371 U. S. at 306). Yet Toolco contends that Section 411 gives the CAB jurisdiction over—and indeed the power to sanction—the private wrongs alleged in the counterclaims.

Toolco's theory as to the scope of CAB jurisdiction would lead to some rather startling and unconscionable results. For example, assume that A is a controlling stockholder of an air carrier and B is a person engaged in a phase of aeronautics. B points a gun at A's head and thereby forces him to sell his stock of the air carrier to B. B applies to the Board for approval of the acquisition of control under Section 408, and the Board grants approval, on the ground that such acquisition will not be inconsistent with the public interest.

Under Toolco's interpretation of Section 414, it would appear that A would be barred from recovering his stock or imposing any civil liability on B for wrongfully coercing him to surrender control of the air carrier. In any event, according to Toolco, A could certainly not maintain such a suit unless and until the CAB expressly "declined to sanction" the wrong complained of. Since Toolco's counterclaims are based on the accusation that the Additional Defendants, in effect, "put a gun" at Hughes' head, the hypothetical is not unrelated to the case at bar.

C. The question of whether the Additional Defendants violated Section 408 is not now before the Court, but in any event Toolco's contention that there was such a violation is without merit.

The Court of Appeals held that the proper disposition of the second counterclaim, which is based upon an alleged violation of Section 408, was a dismissal for lack of jurisdiction, because "under that section the Board is empowered to investigate alleged violations, and the district court was without power to adjudicate this issue" (R. 1432). This ruling by the Court of Appeals is not being challenged by any party in this Court. It has always been our position that the question of a Section 408 violation was strictly one for the CAB (B-84, B-109, B-148). Nor do we claim that a CAB inquiry into this question could in any way be precluded by the dismissal with prejudice of Toolco's counterclaims which the Court of Appeals upheld.

Toolco has devoted a substantial portion of its brief to an attempt to show that Metropolitan, Equitable and Irving are in fact engaged in a "phase of aeronautics", and have acquired control of TWA without the approval of the Board in violation of Section 408. We do not believe that this issue should be considered at this time, as it has nothing to do with the correctness of the decision under review. However, since Toolco's argument as to the effect of *Panagra* on the counterclaims is based entirely on this contention, we will demonstrate that it is without merit.

In the first place, as shown above at pages 49-50, the CAB's order of December 29, 1960 negates any presumption that a Section 408 violation has occurred.

Toolco attempts to add color to its argument that Section 408 has nevertheless been violated by asserting that "the Board has recognized that it has jurisdiction over the matters in issue" (Toolco Br., p. 43). That statement is false. By its order of July 9, 1963 in Docket 14314, the Board noted that "the parties have raised serious questions as to whether the Board has jurisdiction over the mat-

ters alleged in the [Toolco] complaint," and asked for briefs as to "whether under the facts set forth in the complaint, the Board has jurisdiction over the subject matter thereof under Sections 408, 409 and 411." Motions to dismiss the complaint, which were filed in September of 1963, are still pending. Toolco vigorously opposed, even though such a dismissal would have removed the jurisdictional impediment to the prosecution of the counterclaims as to which Toolco now professes to be concerned.

Significantly, the CAB's Bureau of Enforcement recommended in a brief dated September 9, 1963 that the Board take no action with respect to the alleged violations of Section 408, in view of the December 29, 1960 order. As stated by the Bureau of Enforcement:

> "* * * [T]he Board has, in principle, approved the role of the lending institutions insofar as this particular complaint is concerned by approving certain facets of the voting trust arrangement in Order E-16195, dated December 29, 1960 * * *. *By Order E-16195, the Board put its imprimatur on the assumption of control of TWA by the voting trustees, i.e., the lending institutions. This act lessens or eliminates the public interest impact of the complaint.* * * * It is recognized that E-16195 does not approve the specific relationships attacked in the Toolco complaint, but the underlying theme of E-16195 is that the voting trust, transferring control from Toolco to the voting trustees, is in the public interest." (Docket 14314, Brief of Bureau of Enforcement, pp. 35-36, and n. 62.)*

Moreover, we submit that there is very little likelihood the CAB would ever hold that the lending institutions are engaged in a phase of aeronautics. "Aeronautics" is defined by Section 101(2) of the Federal Aviation Act (49 U. S. C. § 1301(2)) as "the science and art of flight", and

* The same brief also recommended that the Board dismiss Toolco's complaint in its entirety as against the Additional Defendants Dillon Read, Hagerty, Oates and Tillinghast (p. 37).

thus a phase of aeronautics is a phase of the science and art of flight. Toolco has cited no authority in support of its novel position that one lending money to an air carrier thereby himself becomes engaged in a phase of the science and art of flight. If a lender is deemed to be in the business of his borrower, then the large commercial banks of this country are undoubtedly in hundreds of businesses at once, and subject to the regulatory authorities relating to each of such businesses. Such a result has never been suggested.

The Federal Aviation Act itself negates the conclusion that a phase of aeronautics should be interpreted so broadly as to embrace the lending of money to air carriers. For example, Section 201(b) (49 U. S. C. § 1321(b)) forbids CAB members from owning "stock in or bonds of any civil aeronautics enterprise," a restriction which no one has ever suggested is applicable to securities of a bank or insurance company.*

It is significant that Congress has never seen fit to give the CAB jurisdiction over financing by air carriers, even though the Board has repeatedly requested such authority. See, *e.g., Trans World Airlines, Inc., Further Control by Hughes Tool Co.*, 12 C.A.B. 192, 224 (1950), and CAB Annual Reports there cited.

Thus Toolco's assertion as to a Section 408 violation, on which it predicates its entire jurisdictional argument, is, we submit, incorrect.

D. Toolco's jurisdictional argument is completely inapplicable to five of these eight respondents.

Finally, the contention which Toolco here presents as to the jurisdiction of the CAB over the counterclaims does not

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* See also Sections 301(b), 302(b), 311, 313(d), 313(e) and 407(c) of the Act (49 U. S. C. §§ 1341(b), 1342(b), 1352, 1354(d), 1354(e), 1377(c)), all indicative of the relatively narrow meaning of the term "aeronautics" which Congress intended.

assist it at all with respect to five of the eight Additional Defendants, namely, Dillon Read, Sessel, Oates, Hagerty and Tillinghast. There is no argument by Toolco, either in its present brief or in its complaint filed with the CAB, that any of these parties has acquired control over TWA, or that any of them is engaged in a phase of aeronautics. Indeed, none of these Additional Defendants was made a party to Toolco's second counterclaim, which is based upon an alleged violation of Section 408 (see AA-49).*

It is difficult to comprehend how the CAB could grant an exemption from the antitrust laws under Section 414 of the Act to persons over whom the CAB has no regulatory jurisdiction. Yet Toolco's entire theory of supersession of the antitrust laws rests on the claimed existence of this exemptive power. In fact, when persons subject to a regulatory exemption combine with others outside the scope of the exemption, the normal rule has been that the members of the regulated industry lose their exemption, rather than that the outsiders gain an exemption by association, as Toolco apparently proposes. See *Maryland & Va. Milk Producers Ass'n* v. *United States*, 362 U. S. 458 (1962); *United States* v. *Borden Co.*, 308 U. S. 188 (1939).

Thus, even if Toolco's jurisdictional theories with respect to the lending institutions were otherwise valid, it is clear that the District Court had sole jurisdiction over the claims against these five Additional Defendants. Accordingly, even under Toolco's theory these Additional Defendants had the right to subject Toolco to discovery and proceed with the Hughes deposition.

Toolco's efforts to "suspend" prosecution of the counterclaims as against *all* the Additional Defendants, even

* Although a sixth additional defendant, Irving, was made a party to the second counterclaim, there was no contention that it had acquired control of TWA, a condition which Toolco attributed only to Metropolitan and Equitable (see AA-51-52).

though its own theory did not furnish any basis whatsoever for doing so as to five of the eight parties in question, vividly demonstrates the lack of good faith which characterized its actions in the District Court.

POINT III

Notice to stockholders under Rule 23(c) was not a prerequisite to dismissal of the derivative counterclaim under the circumstances presented below.

Tooleo's final contention is that, even assuming that dismissal of its counterclaims with prejudice was otherwise proper, Fed. R. Civ. P. 23(c) required notice to TWA's other stockholders before Tooleo's derivative counterclaim could be dismissed. The District Court's omission of this step is thus claimed to be prejudicial error.

Tooleo sheds crocodile tears for the minority stockholders of TWA, who, says Tooleo, may be barred by the judgment below from pursuing a claim, 78% of which would accrue to the benefit of Tooleo as majority stockholder. There is no pressing reason for this Court to examine at this time the effect of the judgment below on stockholders other than Tooleo. That question can be faced when and if some minority stockholder is held to have been barred. But assuming, as Tooleo contends, that the judgment here does have *res judicata* effect under Rule 41(b), we shall show that the action of the District Court was entirely consistent with the intent and long-standing interpretation of Rule 23(c).

For at least twenty-five years, the lower federal courts have consistently interpreted Rule 23(c) as applying only to voluntary dismissals, and not to an involuntary dismissal by the court on the merits. *Partridge v. St. Louis Joint Stock Land Bank*, 130 F. 2d 281, 286 (8th Cir. 1942); *Pelelas v. Caterpillar Tractor Co.*, 113 F. 2d 629, 633 (7th

Cir.), *cert. denied*, 311 U. S. 700 (1940); *Hutchinson* v. *Fidelity Ins. Ass'n*, 106 F. 2d 431, 436 (4th Cir. 1939); *Smith* v. *Industrial Securities Corp.*, 49 F. Supp. 959, 960 (D. Conn. 1943); *Mullins* v. *De Soto Securities Corp.*, 45 F. Supp. 871, 886 (W. D. La. 1942), *modified on other grounds*, 136 F. 2d 55 (5th Cir. 1943); *Massaro* v. *Fisk Rubber Corp.*, 36 F. Supp. 382, 386 (D. Mass. 1941).

Toolco begrudgingly concedes this to be a proper interpretation of Rule 23(c), but seeks to limit the exception to situations where there has been a "hearing on the merits" (Toolco Br., p. 67). If Toolco means by this that the district court must conduct a trial in order to dispense with the notice requirement, it misconceives the existing rule: of the six cases cited above, only one (*Hutchinson* v. *Fidelity Ins. Ass'n*, *supra*) involved a situation in which oral testimony was presented. In one case, *Partridge* v. *St. Louis Joint Stock Land Bank*, *supra*, dismissal was based on failure to prosecute.

Actually, as has been demonstrated in Point I, *supra*, a dismissal for refusal to make discovery is tantamount to a dismissal on the merits. Refusal to disclose material evidence in a party's possession raises a factual inference that disclosure would show lack of merit in that party's case. *Hammond Packing Co.* v. *Arkansas*, *supra*. Thus the situation is equivalent to one where Toolco officers and agents admitted facts at trial which defeated Toolco's derivative claim.

The presumption of lack of merit is particularly compelling under the circumstances presented here. Toolco and Hughes were major participants in the events upon which the derivative counterclaim is based and had peculiar knowledge of crucial facts. Toolco had much more incentive than the average stockholder to prosecute its claim to judgment. Not only did it stand to benefit to the extent of 78% from any recovery on TWA's behalf, but

establishment of the derivative counterclaim would operate as a complete defense to TWA's damage claim against Toolco.* In addition, success of the derivative counterclaim might result in returning control of TWA to Toolco.

Toolco raises the spectre that approval of Toolco's dismissal here will open the door to collusive settlement of derivative actions by deliberate failure to comply with discovery orders (Toolco Br., p. 68, n. 2). But the district courts have ample power to deal with collusion when it appears. In motions for summary judgment under Rule 56, which are unquestionably "hearings on the merits", the rule has been developed that where the defendant's motion is unopposed, the judgment is a "consent judgment" with respect to which Rule 23(c) is applicable. *Certain-Teed Products Corp.* v. *Topping*, 171 F. 2d 241, 243 (2d Cir. 1948); *Brendle* v. *Smith*, 7 F. R. D. 119, 120 (S. D. N. Y. 1946); *cf. Winkelman* v. *General Motors Corp.*, 39 F. Supp. 826, 831 (S. D. N. Y. 1940). The same reasoning would apply to an unopposed dismissal under Rule 37 or Rule 41(b).

That Toolco's own dismissal was neither voluntary nor collusive is evidenced by its presence in this Court and by its vigorous opposition to the Additional Defendants' motion to dismiss below. Thus judgment here was "on the merits" and Rule 23(c) does not apply.

Assuming, as Toolco does, that minority stockholders are bound by the consequences of Toolco's acts, there is nothing shocking or improper in such a result. It is inherent in the nature of a true class action—of which a stockholder's derivative action is one—that one litigant acts on behalf of all. Non-intervening members of the class must necessarily bear the risk that their representative will

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* Recovery of TWA's damages from the Additional Defendants would help Toolco (a) on the theory that they, not Toolco, caused such damage and (b) under the doctrine that TWA is entitled to but one satisfaction for its damage.

present their case inadequately, just as they share gratuitously in the benefits of a successful prosecution.

Toolco's suggestion that minority stockholders—or a TWA under Toolco's control—should be free to litigate the claim which Toolco itself is barred by misconduct from prosecuting is highly unfair. The result could well be to permit Toolco to obtain 78% of the benefits of a recovery from the Additional Defendants while withholding the evidence which would establish their defense.

A derivative claim, such as that presented by Toolco, is an asset of the corporation, not of its stockholders. If TWA itself had brought the claim and it had been dismissed with prejudice under Rule 37 or Rule 41(b), clearly all stockholders would be precluded from resurrecting the claim in another action. There is no policy compelling a different result if the claim is brought derivatively by a majority stockholder.

CONCLUSION

The judgment of the Court of Appeals should be affirmed.

Respectfully submitted,

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February 18, 1963.